the Freeman

Ideas on Liberty

JULY 1983

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Bureaucracy

by Ludwig von Mises

This 1944 classic clearly distinguishes between bureaucratic management and profit management.

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Ludwig von Mises (1881–1973) was the internationally acclaimed exponent of the Austrian School of Economics and is the author of a shelf of major books dealing with economic theory and social practice.

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Robert Bearce

YOUR FREEDOM– WHAT ABOUT IT?

MORE than one thoughtful observer has advised us that "history repeats itself because no one listens the first time." This truth should challenge all those who truly value freedom. History is the tragic story of nations that have lost their liberty through indifference and complacency.

The reasons for the destruction and loss of freedom are clear. We are capable of understanding how freedom is threatened. Yet, despite the warnings of past experience, America and other relatively free nations of the world are committing the same mistakes which ultimately lead to economic collapse and political despotism.

Will we continue to ignore the lessons that should be learned from history regarding the conflict between liberty and tyranny?

Writing over a century ago, Frederic Bastiat asked the French people a similar question. With sound judgment and courage of conviction, he spoke out vigorously for freedom. Serving as a member of the French Legislative Assembly, he placed liberty in perspective—a timeless perspective we need if we are to remain free.

"Actually," wrote Bastiat, "what is the political struggle that we witness? It is the instinctive struggle of all people toward liberty. And what is this liberty, whose very name makes the heart beat faster and shakes the world? Is it not the union of all liberties—liberty of conscience, of education, of association, of the press, of travel, of labor, of trade? In short, is not liberty the freedom of every person to make full use of his faculties, so long as he does not harm other persons while doing so?"

Consider Bastiat's words. Consider them carefully. He understood freedom and defended it at a time

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when France was plunging toward complete socialism—"legal" despotism. In 1848, French politicians were proposing a multitude of idealistic plans for directing France's political, social, and economic life. These blueprints for perfecting society were made in the name of "freedom," "helping the poor," "justice," and so on. The socialists talked boldly about liberty and compassion, but their political/economic philosophy was nothing new. It was founded upon the same beliefs which had caused so much suffering in the past, so much oppression, misery, despotism.

Just as freedom was widely misunderstood during Bastiat's day, there is widespread lack of understanding about freedom in the United States today. Many politicians, members of the mass media, those in the academic community, and just average citizens fail to comprehend the true meaning of freedom.

Freedom is the right of each individual to work toward the highest level of achievement consistent with his own effort and God-given abilities. True freedom is both the capacity and responsibility to exercise personal judgment. We have free choice, but we also have to abide by the consequences of our actions. This acceptance of personal accountability brings a justified sense of dignity, self-worth, and integrity to individuals. We learn by our mistakes and grow in our efforts to lead moral, productive lives. As we accept individual accountability, we develop according to how we use our physical and mental abilities.

Four Basic Principles

We have enjoyed the blessings of this freedom because we were at one time firmly committed to four basic principles of liberty. Individuals are free only when:

(1) They accept responsibility for their own daily lives,

(2) They are safe from criminal elements and internal strife,

(3) They are secure against foreign domination,

(4) They are safe from the abuse of domestic power and authority in the hands of their own government.

A deep, honest faith in individual freedom inspired the Declaration of Independence and the Constitution. The Founding Fathers understood the four essentials of freedom, and they knew what was required to protect freedom. A free society must be founded upon *just* law and order. Government laws should be the *just* means of guarding each citizen's rights—"life, liberty, and the pursuit of happiness."

Free people need the collective force of government authority, but that legal power must be clearly defined and restricted. We accept a certain amount of governmental authority in place of acting individu-

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ally. Instead of everyone being his own policeman and F.B.I agent, we give these roles to the government. History, however, shows that governments have an eventual tendency to go beyond their legal authority, violating instead of protecting the rights of law-abiding individuals.

Such corruption and abuse of government power threatens freedom today. Our critical problem in America is a wayward political philosophy—a philosophy of government which rejects the principles of the Declaration of Independence and the Constitution. Whereas the Founding Fathers believed in limited government, we have allowed our federal government to grow, grow, grow. Most legislators continue to inform us solemnly that government can solve our problems, "correct" the economy, provide jobs, and otherwise map out America's future.

Deadly as gangrene, the federal government gradually spreads and eats at the life of freedom—regardless of the truly courageous efforts of some in government to restrict government power and authority.

To the extent that the collective force of the federal government destroys personal accountability and self-responsibility, we will lose our liberties. It is a matter of government trying to do for us what we can and should do for ourselves. To the extent we trust lawmakers to be the mighty problem-solvers of our real or imagined social/economic ills, we will see the deterioration of freedom.

The Power to Tax May Be a Means to Plunder

With the power of taxation, the lawmaker can tackle what *he* believes to be the problems facing society. By way of *our* tax dollars, Congress finances some of the projects which *it* thinks will be just, good, and right for society. Frederic Bastiat would call their attention to one aspect of such government financing:

"Nothing can enter the public treasury for the benefit of one citizen or one class unless other citizens and other classes have been *forced* to send it in. If every person draws from the treasury the amount that he has put in it, it is true that the law then plunders nobody. But this procedure does nothing for the persons who have no money. It does not promote equality of income. The law can be an instrument of equalization only as it takes from some persons and gives to other persons. When the law does this, it is an instrument of plunder."

Bastiat's use of the word "plunder" may sound somewhat exaggerated or old-fashioned, but we ought to think about how our tax money is spent.

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How much of it goes to the government's legitimate responsibility of maintaining justice and providing for the national defense? On the other hand, what amount is used to finance domestic programs which benefit special-interest groups? How much is spent to obtain the votes of people demanding some "right" from the government—a right to guaranteed income, right to welfare, right to a subsidy, right to guaranteed jobs, right to a college grant, right to a guaranteed profit, and the like?

Those are false, non-existent rights, and they can be fulfilled by 100 Senators and 435 Congressmen only through plunder.

"But how is this legal plunder to be identified?" Bastiat asked. "Quite simply. See if the law takes from some persons what belongs to them, and gives it to other persons to whom it does not belong. See if the law benefits one citizen at the expense of another by doing what the citizen himself cannot do without committing a crime."

A crime would be committed if Congressman Joe stole Senator Sam's car. Both Joe and Sam, along with others in Congress, imitate such an offense when they use coercive legislation to take from some people in order to give to others. Legal plunder operates easily under the cloak of the "democratic process." Being a freely elected official, a Senator or Congressman assumes that he has the right to enact laws favoring particular groups in society—even when this action deprives other citizens of their rightful earnings.

Although individuals who truly understand the proper functions of government see how and why elected officials act the way they do, the truth about government must be made available to those who do not comprehend the meaning of freedom. We should be able to clearly explain the nature of government force and authority—legitimate government power.

The Bounds of Lawful Defense

"What, then, is law?" Bastiat asked, speaking of government force and authority. "It is the collective organization of the individual right to lawful defense. Each of us has a natural right—from God—to defend his person, his liberty, and his property. These are the three basic requirements of life, and the preservation of any one of them is completely dependent upon the preservation of the other two. For what are our faculties but the extension of our individuality? And what is property but an extension of our faculties?"

Our faculties include our intellects, talents, physical and mental abilities. Some of these are natural while others are acquired. They enable us to handle the responsibility of living. When millions of free in-

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dividuals voluntarily use their faculties to work and produce, we have economic freedom—a capitalistic, free enterprise, free market system.

Actually, free enterprise or capitalism is not a stale, dull "system." No self-appointed group of legislators or economic theorists designed it. Rather, free enterprise is the natural, vibrant collaboration of free individuals laboring together cooperatively, competitively, voluntarily. Economic freedom allows individuals to use their skills, wisdom, and energies to manage their *own* lives.

Free enterprise depends upon personal freedom and accountability, private property, and a free market. Economic freedom places the matter of living upon the shoulders of the individual. This is where it ought to be—not in the hands of government. Unless an individual can control and use his own possessions (private property and income) he cannot fully decide for himself how he will work, direct his own life, house and feed his family.

Choice in the Market Place

Working and associating with other free people, the individual finds himself in a free market. Here he has free choice. He can choose his own employment, rejecting the pay offered at other jobs if he so wishes. Between him and his employer there should be freedom to exchange a solid day's work for a fair wage. At the supermarket or appliance store, the individual again expresses freedom of choice. Free enterprise enables him not only to go to different stores but to buy from a wide assortment of products and services. He is not forced to purchase goods he does not like or use the services of businesses he distrusts.

The "he" and the "individual" in all of this voluntary action are not abstract human beings, but WE—whoever we are and wherever we live, as long as we are willing to accept the responsibilities of freedom.

If we are to have economic freedom, the free market must operate within a framework of just laws. Thus, government has the function of prohibiting violence, force, theft, and fraud. Laws should be administered which protect private property and require individuals to live up to their freely made agreements.

"Under such an administration," wrote Bastiat, "everyone would understand that he possessed all the privileges as well as all the responsibilities of his existence. No one would have any argument with government, provided that his person was respected, his labor was free, and the fruits of his labor were protected against all unjust attack."

Free, private enterprise is the only way we can freely use our creative energies for, not only our own good, but the remainder of society. We (free

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individuals)—not economic legislation from Congress—are the basis for America's strength and stability. This general prosperity can develop when there is efficient, industrious production of goods and services. Such performance is generated when individuals and businesses are eager to work hard and honestly. There must be the *incentive* to do so.

That incentive is found in competition and the profit motive. Competition encourages us to make the best use of our faculties. The just reward of profit goes to industries, businesses, employers, and employees as we freely combine our energies, creativity, and labor. Profits are made without having coerced the consumer. They are made because enough of us *freely* decided to purchase a particular good or pay for a particular service—*not* because the federal government "stimulated" the economy or tried to "protect" some industries from so-called "unfair competition."

Freedom Is Threatened

Working upon the moral grounds of competition, individual freedom, and profits, free enterprise has brought past prosperity to the United States. Our progress can be traced back to a respect for the worth and dignity of the individual. Economic freedom, however, is under attack.

Invariably, we find ourselves and the preservation of freedom again facing the issue of government intervention and plunder. Politicians and others simply will not allow our economic activities to be free and voluntary. They would deny us the right to go about our daily lives in a free market atmosphere—making an honest living for ourselves and our families. Realizing that there are some not-so-productive elements of society (individuals, businesses or whoever) who are willing to participate in plunder, politicians proceed to abuse government power and authority.

"Man," Bastiat said, "can live and satisfy his wants only by ceaseless labor; by the ceaseless application of his faculties to natural resources. This process is the origin of property. But it is also true that a man may live and satisfy his wants by seizing and consuming the products of the labor of others. This process is the origin of plunder. Now since man is naturally inclined to avoid pain—and since labor is pain in itself—it follows that men will resort to plunder whenever plunder is easier than work. History shows this quite clearly."

Indeed it does, and through taxation, government regulations, spending power, grants, and the like, we still see plunder at work. Although America still experiences many of the blessings of free enterprise, we are being subjected to greater doses of destructive plunder.

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As legislators and other groups continue to call upon the federal government to create more programs and to pass more "laws," we need to hear forcefully and clearly from more individuals like Bastiat: "It is not true that the function of law is to regulate our consciences, our ideas, our wills, our education, our opinions, our work, our trade, our talents, or our pleasures. The function of law is to protect the free exercise of these rights, and to prevent any person from interfering with the free exercise of these same rights by any other person."

That is the one basic fact free people must understand and explain to others—other people who daily work for more government controls, laws, aid, intervention, and so on.

How Government Grows

Existing government bureaucracies plod forward—regulating our lives, taxing our hard-earned incomes, and infringing upon personal freedom. Those who will never give up calling for more and more government will speak in honorable, compassionate terms. Their objectives will supposedly be achieved in a "free, responsive, caring, responsible, democratic" manner. They are against "oppression, discrimination, and prejudice." They uphold the "rights and needs" of the "poor," the elderly, the "disadvantaged," the handicapped, the "needy," and so on. "Social consciousness" and "the public interest" weigh heavily upon their minds.

To each problem they believe exists in every area of the United States, their automatic question is: "How can the federal government solve it?"

Daily, we hear Senators and Congressmen soberly, eagerly, and forcefully asking: "How can the federal government solve this problem?"

Their concern appears honorable enough, but beneath it lies distrust. They distrust the individual. They distrust freedom. They have faith only in their own good intentions and the power of government. Other individuals, so they vainly think, are not capable of managing their own lives. Voluntary charity will not work. Individuals, they claim, either cannot or will not freely help others who are truly in need of aid. Along with this distrust for the average citizen in Salt Lake City, Peoria, Dayton, and Muskogee, there is a hint of self-righteousness. Frederic Bastiat describes it aptly:

"The organizers maintain that society, when left undirected, rushes headlong to inevitable destruction because the instincts of the people are so perverse. The legislators claim to stop this suicidal course and to give it a saner direction. Apparently, then the legislators and the organizers have received from

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Heaven an intelligence and virtue that place them beyond and above mankind; if so, let them show their titles to this superiority.

"They would be the shepherds over us, their sheep. Certainly such an arrangement presupposes that they are naturally superior to the rest of us. And certainly we are fully justified in demanding from the legislators and organizers proof of this natural superiority."

This presumed superiority Bastiat was talking about over a century ago is seen today by the confidence in which elected government officials promote their legislation for social and economic planning. Similar programs have failed throughout history, and the same manipulation fails in socialized nations today. Ignoring past and present, spokesmen for more government power somehow feel their own efforts at organizing society will be much superior.

Organize, regulate, and coerce, they will—unless those who understand freedom are willing to bear the responsibilities of that freedom. First, of course, we have the primary responsibility to comprehend the basic principles of liberty, free market economics, limited government, and so on. Having that understanding of and appreciation for freedom is the critical foundation we must have before we can actively labor for a stable, free, prosperous nation.

If we have the basic grasp of freedom (always learning more and growing in the faith) we also make that faith in freedom a living reality in our daily lives—not drifting away to join the large numbers of those who unknowingly become a part of the "More, More, More Government" crowd.

Our labor for liberty remains the same. We must make our lives, our attitudes, and our actions consistent with "what we preach." Those who would destroy true freedom and justice—as well-intentioned as they may be in their beliefs—will never stop promoting more government spending, power, and authority. While they undermine freedom, we should be as tireless in our own efforts—efforts to *preserve* the freedom they are attempting to take from us, efforts to *restore* the freedom we have already lost, and efforts to *expand* the blessings of freedom.

It's your freedom. What about it?

All quotations by Bastiat are from *The Law,* written in 1850, translation by Dean Russell in 1950. 76 pages, paperback.

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Elgin Groseclose

Prescription for Economic Health

THAT radical reform is needed for an economic system that periodically produces booms and busts, inflation and deflation, is recognized by a growing number of students. The prescriptions for reform are numerous and varied. Among the defects of the system, however, are several that continue to be ignored—indeed, are regarded not as defects but with reverence as healthful agents of progress.

At the risk of being read out of the profession as eccentric or iconoclastic, I list a few that have produced more confusion than progress, more chaos than order, and that need examination as to their utility.

Dr. Elgin Groseclose (deceased April 4, 1983) was a financial consultant in Washington, D.C. He was the author of *Money and Man* (1934, 4th edition 1976) and *America's Money Machine* (1966, 1980). He served also as executive director of the Institute for Monetary Research.

The Statistics Syndrome

Statistics have been characterized by the English industrialist Arnold Wilson as something economists collect as others gather antiques. So treasured are they that a vast computer industry today is devoted to compiling, analyzing and storing statistical data. No self-respecting administrator would think of making a decision without the aid of his computer. Chief among the statistical totems are various kinds of indexes, and high on the column is one which business and government decision makers watch with the avidity of a gambler watching a roulette wheel. This is the Gross National Product, or GNP. Purportedly, the GNP records the changing volume of goods and services produced by the economy. A rising GNP suggests that the country is producing more, and

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the figure suffuses the observer with a pleasant euphoria.

Actually the GNP is not a measure of production, but of consumption. A rising GNP may indicate that the country is producing more while actually it is producing less.

Thus, a restaurant meal for two may add as much as $100 to the GNP, if taken at the Lion d'Or, but only $5 if eaten at Burger King, and even less if prepared at home. In an inflationary period, when vast sums are spent in restaurants, theatres, travel and Las Vegas casinos, the GNP index may indicate a state of economic well-being when actually physical production is declining and general poverty rising.

Better political and business decisions and improved economic health would follow if the GNP index were abolished or radically modified.

The Dilemma of the CPI

Another index that has gotten the government into trouble is that of the consumer price index—since pensions, Social Security and welfare payments are adjusted periodically with the indicated change in this index. How accurately the index measures the real burden of rising prices is a question few examine, and how unwillingly the public would accept a correction has been recently demonstrated by the hullabaloo over the substitution of rental costs for housing costs in the series upon which the index is based. In any case, the process has now bankrupted the Social Security system, and those who can—like state and municipal and non-profit employees—are leaving it with the good sense of rats abandoning a sinking ship.

The latest indexing, which has become a political dilemma since it may bankrupt the federal treasury, is to be applied in 1985 to income tax rates. The purpose is to relieve taxpayers of what is called bracket creep—the higher tax burden that applies as income increases as a result of inflation. The effect will be to reduce federal revenues at a time when the indexing of the entitlement payments is increasing expenses. If the price level were stabilized, there would be no need for the indexes and indexation. They serve, instead, to push prices steadily higher, like a ratchet on a tire lift. If honest money were restored to the country, there would be little need of these indexes.

The Money Mill

The whole mess created by indexes and indexing would not have arisen except for the money mill on the Potomac which keeps issuing paper currency like the legendary mill at the bottom of the sea that grinds out salt with nobody to stop it. Money in circulation—and we

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mean the legal tender currency issued by the Fed, not the M1, M2, and the like, of the economists—has doubled in the past decade alone, from $54.6 billion in 1972 to $126.6 billion today. And this goes on despite the impression given out of a "tight money policy."

It is too well known to require theoretical demonstration that prices are influenced by the amount of purchasing power in the market, and that inflation is the result of too much money in circulation.

Instead of curtailing the power of the Fed to issue currency, Congress has steadily broadened its powers until today the Fed can turn into legal tender currency practically any debt obligation it sees fit, including Polish, Turkish, Brazilian or Argentinian bonds. This brings us to our next proposal.

Wean the Banks

The Federal Reserve System came into being as a system of super banks—actually pawn shops—to assist commercial banks in distress by taking up their short term loans and giving them cash in the form of legal tender currency, or a deposit at the reserve bank that was equivalent to cash (since it could at any time be turned in for cash).

The so-called panics, depressions, or crises which the country goes through periodically are not the result of a shortage of money in the economy, but a shortage of cash or credit on the part of debtors. The principal debtors, of course, are the banks, since their balance sheets represent mostly liabilities supported by a thin margin of proprietors' capital (less than 10 per cent generally).

After the passage of the Federal Reserve Act, banks gradually let their capital drop from a mean of 25 per cent or more of total liabilities to the present low ratios (for the 15 biggest banks the ratio is less than 5 per cent).

The banking system is like a brood of pigs, grown to sizable porkers, but still clinging to mother sow. It is time they were weaned and made to forage for themselves. In short, too long have money and banking been linked in economic literature. The management of the banking system should be separated from the administration of the money system.

Subsidized Debt

The world today would not be in the depression it is in but for the burden of debt. Farmers complain they can't meet their mortgage payments; home owners, likewise; corporate bankruptcies—now at flood—occur because companies cannot meet their debt payments. Third World countries are half a trillion dollars in debt, a third of it owing to U.S. banks.

How did the world get in this mess?

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Largely from encouragement by government. Through the International Monetary Fund and the World Bank, indigent governments around the world have been led to borrow beyond their means for all sorts of doubtfully viable projects until now they are bogged down in a mire of debt. Home ownership has been fostered—no doubt, for the public good—by low cost loans, or government guaranteed loans and deductibility of interest payments. Farmers have been encouraged to expand their food production; many increased their acreage by buying land at high prices, financed by mortgages.

Banks have been permitted to increase their debt (deposit liabilities) in relation to equity capital until most banks are in difficulty, many of them technically insolvent.

One measure to reduce the mania for going into debt is to restrict the deductibility of interest payment from taxable income. While no doubt justified as a social measure to encourage home ownership, the deductibility of corporate interest payments is contrary to shareholders' best interests since it encourages corporate managers to leverage assets, engage in mergers that are justified only by tax advantages, and shift the enterprise from producing goods to that of producing financial gain.

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Corruption of the Coin

At the beginning of the sixteenth century the astronomer Copernicus addressed to the king of Poland his treatise, "Monete Cudende Ratio," which opens with this broad declaration: "Numberless as are the evils by which kingdoms, principalities and republics are wont to decline, these four are, in my judgment, most baleful: civil strife, pestilence, sterility of the soil, and corruption of the coin. The first three are so manifest that no one can fail to apprehend them; but the fourth, which concerns money, is considered by few, and those the most reflective, since it is not by a blow, but little by little and through a secret approach, that it destroys the state."

FRANCIS A. WALKER, from the book *Money*, published by Henry Holt and Company, Boston, 1891

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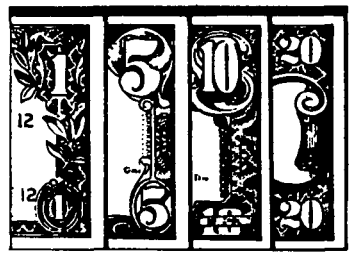
Clarence B. Carson

THE CONSTITUTION AND PAPER MONEY



THE UNITED STATES CONSTITUTION does not mention paper money by that name. Nor does it refer to paper currency or fiat money in those words.[1] There is only one direct reference to the origins of what we, and they, usually call paper money. It is in the limitations on the power of the states in Article I, Section 10. It reads, "No State shall . . . emit Bills of Credit. . . ." Paper that was intended to circulate as money but was not redeemable in gold and silver was technically described as bills of credit at that time. The description was (and is) apt. Such paper is a device for expanding the credit of the issuer. There is also an indirect reference to the practice in the same section of the Constitution. It reads, "No State shall . . . make any Thing but gold and silver Coin a Tender in Payment of Debts. . . ." Legal tender laws, in practice, are an essential expedient for making unredeemable paper circulate as money. Except for the one direct and one indirect reference to the origin and means for circulating paper money, the Constitution is silent on the question.

With such scant references, then, it might be supposed that the makers of the Constitution were only incidentally concerned with the dangers of paper money. That was hardly the case. It loomed large in the thinking of at least some of the men who were gathered at Philadelphia in 1787 at the Constitutional Convention. There were two great objects in the making of a new constitution: one was to provide for a more

Dr. Carson has written and taught extensively, specializing in American intellectual history. He is the author of several books, his most recent being *Organized Against Whom? The Labor Union in America.* He is working at present on A Basic History of the United States to be published by Western Goals, Inc.

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energetic general government; the other was to restrain the state governments. Moreover, the two objects had a common motive at many points, i.e., to provide a stronger general government which could restrain the states.

Measures to Prevent a Flood of Unbacked Paper Money

One of the prime reasons for restraining the state governments was to prevent their flooding the country with unbacked paper money. James Madison, one of the leaders at the convention, declared, in an introduction to his notes on the deliberations there, that one of the defects they were assembled to remedy was that "In the internal administration of the States, a violation of contracts had become familiar, in the form of depreciated paper made a legal tender. . . ."[2] Edmund Randolph, in the introductory remarks preceding the presentation of the Virginia Plan to the convention, declared that when the Articles of Confederation had been drawn "the havoc of paper-money had not been foreseen."[3]

Indeed, as the convention held its sessions, or in the months preceding it, state legislatures were under pressure to issue paper money. Several had already yielded, or taken the initiative, in issuing the unbacked paper. The situation was out of control in Rhode Island, and had been for some time. Rhode Island refused to send delegates to the convention, and the state's reputation was so bad that the delegates there were apparently satisfied to be spared the counsels of her citizens. Well after the convention had got underway, a motion was made to send a letter to New Hampshire, whose delegates were late, urging their attendance. John Rutledge of South Carolina rose to oppose the motion, arguing that he "could see neither the necessity nor propriety of such a measure. They are not unapprized of the meeting, and can attend if they choose." And, to clinch his argument, he proposed that "Rhode Island might as well be urged to appoint & send deputies."[4] No one rose in defense of an undertaking of that character.

The ill repute of Rhode Island derived mainly from that state's unrestrained experiments with paper money. Rhode Island not only issued paper money freely but also used harsh methods to try to make it circulate. The "legislature passed an act declaring that anyone refusing to take the money at face value would be fined £100 for a first offense and would have to pay a similar fine and lose his rights as a citizen for a second."[5] When the act was challenged, a court declared that it was unconstitutional. Whereupon, the legislature called the judges before it, interrogated them, and dismissed several from office. The legislature

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was determined to have its paper circulate.

The combination of abundant paper money and Draconian measures to enforce its acceptance brought trade virtually to a halt in Rhode Island. A major American constitutional historian described the situation this way:

> The condition of the state during these days was deplorable indeed. The merchants shut their shops and joined the crowd in the bar-rooms; men lounged in the streets or wandered aimlessly about. . . . A French traveller who passed through Newport about this time gives a dismal picture of the place: idle men standing with folded arms at the corners of the streets; houses falling to ruins; miserable shops offering for sale nothing but a few coarse stuffs . . . ; grass growing in the streets; windows stuffed with rags; everything announcing misery, the triumph of paper money, and the influence of bad government. The merchants had closed their stores rather than take payment in paper; farmers from neighboring states did not care to bring their produce. . . . Some . . . sought to starve the tradesmen into a proper appreciation of the simple laws of finance by refusing to bring their produce to market.[6]

But there was more behind the Founders' fears of paper money than contemporary doings in Rhode Island or general pressures for monetary inflation. The country as a whole had only recently suffered the searing aftermath of such an inflation. Much of the War for Independence had been financed with paper money or, more precisely, bills of credit.

A Surge of Continentals

Even before independence had been declared the Continental Congress began to emit bills of credit. These bills carried nothing more than a vague promise that they would at some unspecified time in the future be redeemed, possibly by the states. In effect, they were fiat money, and were never redeemed. As more and more of this Continental currency was issued, 1776–1779, it depreciated in value. This paper was joined by that of the states which were, if anything, freer with their issues than the Congress. In 1777, Congress requested that the states cease to print paper money, but the advice was ignored. They did as Congress did, not what it said.

At first, this surge of paper money brought on what appeared to be a glow of prosperity. As one historian described it, "the country was prosperous. . . . Paper money seemed to be the 'poor man's friend'; to it were ascribed the full employment and the high price of farm products that prevailed during the first years of the war. By 1778, for example, the farmers of New Jersey were generally well off and rapidly getting out of debt, and farms were selling for twice the price they had brought during the period 1765–1775. Trade and commerce were likewise stimu-

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lated; despite the curtailment of foreign trade, businessmen had never been so prosperous."[7]

The pleasant glow did not last long, however. It was tarnished first, of course, by the fact that the price of goods people bought began to rise. (People generally enjoy the experience of prices for their goods rising, but they take a contrary view of paying more for what they buy.) Then, as now, some blamed the rise in prices on merchant profiteering.

As the money in circulation increased and expectations of its being redeemed faded, a given amount of money bought less and less. This set the stage for speculative buying, holding on to the goods for a while, and making a large paper profit on them. There were sporadic efforts to control prices as well as widespread efforts to enforce acceptance of the paper money in payment for debts. These efforts, so far as they succeeded, succeeded in causing shortages of goods, creditors to run from debtors trying to pay them in the depreciated currency, and in the onset of suffering.

Runaway Inflation

By 1779, the inflation was nearing the runaway stage. "In August 1778, a Continental paper dollar was valued (in terms of gold and silver) at about twenty-five cents; by the end of 1779, it was worth a penny." "Our dollars pass for less this afternoon than they did this morning," people began to say.[8] George Washington wrote in 1779 that "a wagon load of money will scarcely purchase a wagon load of provisions."[9] It was widely recognized that the cause was the continuing and ever larger emissions of paper money. Congress resolved to issue no more in 1779, but it was all to no avail. Runaway inflation was at hand. In 1781, Congress no longer accepted its own paper money in payment for debts, and the Continentals ceased to have any value at all.

A good portion of the dangers of paper money had been revealed, and reflective people were aware of what had happened. Josiah Quincy wrote George Washington "that there never was a paper pound, a paper dollar, or a paper promise of any kind, that ever yet obtained a general currency but by force or fraud, generally by both."[10] A contemporary historian concluded that the "evils which resulted from the legal tender of the depreciated bills of credit" extended much beyond the immediate assault upon property. "The iniquity of the laws," he said, "estranged the minds of many of the citizens from the habits and love of justice. . . . Truth, honor, and justice were swept away by the overflowing deluge of legal iniquity. . . ."[11]

But the economic consequences of the inflation did not end with the demise of the Continental currency.

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Instead, it was followed by a deflation, which was the inevitable result of the decrease in the money supply. The deflation was not immediately so drastic as might be supposed. Gold and silver coins generally replaced paper money in 1781. Many of these had been out of circulation, in hiding, so long as they were threatened by tender law requirements to exchange them on a par with the paper money. Once the threat was removed, they circulated. The supply of those in hiding had been augmented over the years by payments for goods by British troops. Large foreign loans, particularly from the French, increased the supply of hard money in the United States in 1781 and 1782. A revived trade with the Spanish, French, and Dutch brought in coins from many lands as well. In addition, Robert Morris's Bank of North America provided paper money redeemable in precious metals in the early years of the decade.

The Impact of Depression

By the middle of the 1780s, however, the deflation was having its impact as a depression. Trade had reopened with Britain, and Americans still showed a distinct preference for British imports. That, plus the fact that the market for American exports in the British West Indies was still closed, resulted in a large imbalance in trade. Americans made up the difference either by borrowing or shipping hard money to Britain. Prices fell to reflect the declining money supply. Those who had gone into debt to buy land at the inflated wartime prices were especially hard hit by the decline in the prices of their produce. Foreclosures were widespread in 1785–1786. This provided the setting for the demands for paper money and other measures to relieve the pressure of the debts. Some people were clamoring for the hair of the dog that had bit them in the first place—monetary inflation—and several state legislatures had accommodated them.

Though there is evidence that the worst of the depression was over by 1787, if not in the course of 1786,[12] paper money issues and agitations for more were still ongoing when the Constitutional Convention met in Philadelphia. In any case, those who had absorbed the lessons of recent history were very much concerned to do something to restrain governments from issuing paper money and forcing it into circulation. There were those who met at Philadelphia, too, who took the long view of their task. They hoped to erect a system that would endure, and to do that they wished to guard against the kind of fiscal adventures that produced both unpleasant economic consequences and political turmoil. Paper money was reckoned to be one of these.

The question of granting power to emit bills of credit came up for dis-

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cussion twice in the convention. The first time was on August 16, 1787. (The convention had begun its deliberations on May 25, 1787, so it was moving fairly rapidly toward the conclusion when the question arose.) The question was whether or not the United States government should have power to emit bills of credit. Congress had such a power under the Articles of Confederation, and most of the powers held by Congress under the Articles were introduced in the convention to be extended to the new government.

Constitutional Convention Debates

Gouverneur Morris of Pennsylvania "moved to strike out 'and emit bills on the credit of the United States'." That is, he proposed to remove the authority for the United States to issue such paper money. "If the United States had credit," Morris said, "such bills would be unnecessary: if they had not, unjust & useless." His motion was seconded by Pierce Butler of South Carolina.

James Madison wondered if it would "not be sufficient to prohibit making them a *tender*? This will remove the temptation to emit them with unjust views. And promissory notes in that shape may in some emergencies be best." (Madison's distinction between bills of credit that may be freely circulated and those whose acceptance is forced by tender laws should remind us that paper instruments serving in some fashion as money are not at the heart of the problem. After all, private bills of exchange had for several centuries been used by tradesmen, and these sometimes changed hands much as money does. They are what we call negotiable instruments, and the variety of these is large. What Madison was getting at more directly, however, was that governments, if they are to borrow money from time to time, may issue notes, and these may be negotiable instruments which may take on some of the character of money in exchanges. But Madison's objection was overcome, as we shall see.)

Gouverneur Morris then observed that "striking out the words will leave room still for notes of a *responsible* minister which will do all the good without the mischief. The Monied interest will oppose the plan of Government, if paper emissions be not prohibited."

However, Morris had moved beyond his motion, which was for removing the power, not specifying a prohibition, and Nathaniel Gorham of Massachusetts brought him back to the point. Gorham said he "was for striking out, without inserting any prohibition. If the words stand they may suggest and lead to the measure."

Not everyone who spoke, however, favored removing the power. George Mason of Virginia "had

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doubts on the subject. Congress he thought would not have the power unless it were expressed. Though he had a mortal hatred to paper money, yet as he could not foresee all emergences [sic], he was unwilling to tie the hands of the Legislature. He observed that the late war could not have been carried on, had such a prohibition existed."

Nathaniel Gorham tried to reassure Mason and others who might have similar doubts by declaring that "The power so far as it will be necessary or safe, is involved in that of borrowing."

Both Positions Argued

On the other hand, John Francis Mercer of Maryland announced that he "was a friend to paper money, though in the present state & temper in America, he should neither propose nor approve of such a measure. He was consequently opposed to a prohibition of it altogether. It will stamp suspicion on the Government to deny it a discretion on this point. It was impolitic also to excite the opposition of all those who were friends to paper money. The people of property would be sure to be on the side of the plan [the Constitution], and it was impolitic to purchase their further attachment with the loss of the opposite class of Citizens."

Oliver Elsworth of Connecticut pronounced himself of the opposite view. He "thought this a favorable moment to shut and bar the door against paper money. The mischiefs of the various experiments which had been made, were now fresh in the public mind and had excited the disgust of all the respectable part of America. By withholding the power from the new Government more friends of influence would be gained to it than by almost any thing else. Paper money can in no case be necessary. Give the Government credit, and other resources will offer. The power [to emit bills of credit] may do harm, never good."

Edmund Randolph of Virginia still had doubts, for he said that "notwithstanding his antipathy to paper money, [he] could not agree to strike out the words, as he could not foresee all the occasions which might arise."

James Wilson of Pennsylvania favored removing the power: "It will have a most salutary influence on the credit of the United States to remove the possibility of paper money. This expedient can never succeed whilst its mischiefs are remembered, and as long as it can be resorted to, it will be a bar to other resources."

Pierce Butler "remarked that paper was a legal tender in no country in Europe. He was urgent for disarming the Government of such a power."

George Mason, however, "was still

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The Integrity of the Coinage

. . . the whole aim and intent of State intervention in the monetary sphere is simply to release individuals from the necessity of testing the weight and fineness of the gold they receive, a task which can only be undertaken by experts and which involves very elaborate precautionary measures. The narrowness of the limits within which the weight and fineness of the coins is legally allowed to vary at the time of minting, and the establishment of a further limit to the permissible loss by wear of those in circulation, is a much better means of securing the integrity of the coinage than the use of scales and nitric acid on the part of all who have commercial dealings. Again, the right of free coinage, one of the basic principles of modern monetary law, is a protection in the opposite direction against the emergence of a difference in value between the coined and uncoined metal. In large-scale international trade, where differences that are negligible as far as single coins are concerned have a cumulative importance, coins are valued, not according to their number, but according to their weight; that is, they are treated not as coins but as pieces of metal.

LUDWIG VON MISES, *The Theory of Money and Credit*

averse to tying the hands of the Legislature *altogether*. If there was no example in Europe as just remarked, it might be observed on the other side, that there was none in which the Government was restrained on this head." His fellow delegates forebore to remind Mason that except for Britain there was hardly a government in Europe that was restrained on that or any other head by a written constitution.

In any case, the last remarks were made by men vehemently opposed to the power. George Read of Delaware "thought the words, if not struck out, would be as alarming as the mark of the Beast in Revelations." John Langdon of New Hampshire "had rather reject the whole plan [the Constitution] than retain the three words," by which he meant "and emit bills."

Denying the Power to Emit Bills of Credit

The vote was overwhelmingly in favor of removing the authority of the United States to emit bills of credit. The delegates voted by states, and 9 states voted in favor of the motion while only 2 opposed it. (New York delegates were not in attendance, and Rhode Island, of course,

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sent none.) It is a reasonable inference from the discussion that the delegates believed that by voting to strike out the words they had removed the power from the government to emit bills of credit. George Mason, who opposed the motion, admitted as much. Moreover, James Madison explained in a footnote that he voted for it when he "became satisfied that striking out the words would not disable the Government from the use of public notes as far as they could be safe & proper; & would only cut off the pretext for a paper currency, and particularly for making the bills a tender for public or private debts."[13]

The other discussion of paper money took place in connection with the powers to be denied to the states in the Constitution. The committee report had called for the states to be prohibited to emit bills of credit without the consent of the United States Congress. James Wilson and Roger Sherman, who was from Connecticut, "moved to insert after the words 'coin money' the words 'nor emit bills of credit, nor make any thing but gold & silver coin a tender in payment of debts'," thus, as they said, "making these prohibitions absolute, instead of making the measures allowable (as in the XIII article) *with the consent of the Legislature of the U.S.*"

Nathaniel Gorham "thought the purpose would be as well secured by the provision of article XIII which makes the consent of the General Legislature necessary, and that in that mode, no opposition would be excited; whereas an absolute prohibition of paper money would rouse the most desperate opposition from its partizans."

To the contrary, Roger Sherman "thought this a favorable crisis for crushing paper money. If the consent of the Legislature could authorise emissions of it, the friends of paper money, would make every exertion to get into the Legislature in order to licence it."[14]

Eight states voted for the absolution prohibition against states issuing bills of credit. One voted against it, and the other state whose delegation was present was divided. The prohibition, as voted, became a part of the Constitution.

Paper Money Rejected

Three other points may be appropriate. The first has to do with any argument that there might be an implied power for the United States government to issue paper money since it is not specifically prohibited in the Constitution. Alexander Hamilton, the man credited with advancing the broad construction doctrine, maintained the opposite view in *The Federalist*. While he was making a case against the adding of a bill of rights, his argument was meant to have general validity. He

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declared that such prohibitions "are not only unnecessary in the proposed Constitution but would even be dangerous. They would contain various exceptions to powers which are not granted; and, on this very account, would afford a colorable pretext to claim more than were granted. For why declare that things shall not be done which there is no power to do."[15] In short, the government does not have all powers not prohibited but only those granted.

Second, this point was driven home by the 10th Amendment when a Bill of Rights was added to the Constitution. It reads, "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." The power to emit bills of credit or issue paper money was not delegated to the United States. More, it was specifically not delegated after deliberating upon whether to or not. The power was prohibited to the states. The logical conclusion is that such power as there may be to emit bills of credit was reserved to the people in their private capacities.

And third, not one word has been added to or subtracted from the Constitution since that time affecting the power of government to emit bills of credit or issue paper money.

Since the United States is once again in the toils of an ongoing monetary inflation, it is my hope that this summary review of the experience, words, and deeds of the Founders might shed light on some of the vexing questions surrounding it.

—FOOTNOTES—

[1]Actually, the phrase, "fiat money," did not come into use until the 1880s. It might have helped the Founders to specify more precisely what they had in mind to prevent, but they had no such term.

[2]E. H. Scott, ed., *Journal of the Federal Convention Kept by James Madison* (Chicago: Albert, Scott and Co., 1893), p. 47.

[3]*Ibid.*, p. 60.

[4]Charles E. Tansill, ed., *Formation of the Union of the American States* (Washington: Government Printing Office, 1927), p. 306.

[5]Merrill Jensen, *The New Nation* (New York: Vintage Books, 1950), p. 324.

[6]Andrew C. McLaughlin, *The Confederation and the Constitution* (New York: Collier Books, 1962), pp. 107–08.

[7]John C. Miller, *Triumph of Freedom* (Boston: Little, Brown and Co., 1948), p. 438.

[8]*Ibid.*, p. 462.

[9]Quoted in Albert S. Bolles, *The Financial History of the United States*, vol. I (New York: D. Appleton, 1896, 4th ed.), p. 132.

[10]*Ibid.*, p. 139.

[11]Quoted in *ibid.*, pp. 177–78.

[12]See Jensen, *op. cit.*, pp. 247–48.

[13]All the discussion and quotations can be found in Tansill, *op. cit.*, pp. 556–57. While there is no way to know if the record of the debates on this and other matters is complete, nothing has been omitted from Madison's notes.

[14]*Ibid.*, pp. 627–38. The committee on style eventually reduced the number of articles in the Constitution to seven, so there is not now an Article XIII, of course.

[15]Alexander Hamilton, *et. al.*, *The Federalist Papers* (New Rochelle, N. Y.: Arlington House, n. d.), pp. 513–14.

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Why Anticapitalism Grows

Henry Hazlitt

A CORRESPONDENT who describes himself as "a 26-year old college graduate who strongly supports a system of free enterprise," recently wrote me to say that he is "continuously confronted with questions that are most difficult to answer." He appended a list of 10 of them, and asked for my comments.

I offer my answer here. To save space, I have not repeated his questions, assuming they can be clearly guessed from my replies.

* * *

Dear Mr. _____:

The number of faults that have been alleged against capitalism are without limit. Few of the allegations have any merit, and when they do the reason will usually be found to lie deep in the weaknesses of human nature itself. Practically all the criticisms tacitly assume that the imputed faults could be easily cured by some form of socialism or communism, or some ad hoc government intervention that would, in fact, usually make the complained-about condition much worse.

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With these preliminary remarks, let me try to give brief answers to your ten questions.

1. Capitalism does depend upon the consumption of natural resources, and some of these could eventually be depleted. But this must happen under any conceivable system of production when the population becomes large enough in comparison with the resources. But capitalism has proved resourceful in finding substitutes or for providing for renewal of resources (as in scientific forestry, for example).

2. There will probably always be some efforts toward collusion and private price-fixing. Encouraging private competition is probably the best cure for this, plus appropriate laws against clearly harmful collusion.

3. Not only do utilities often give lower rates to those who use more power; nearly all sellers give lower rates to bigger consumers because they can be supplied with the commodity at a lower cost. If big automobile companies consume more steel than a small hardware manufacturer, this does not necessarily mean that big companies are using steel more wastefully.

4. Private capitalism means free competition. Capitalism has far less tendency toward concentration than does socialism, and well-drafted laws can prevent coercive methods of concentration. True, big companies can sometimes lower prices excessively to try to drive out small competitors, but they can do this only at a serious cost to themselves. It is more often alleged than proved that such practices happen with any real frequency.

5. True, adequate capital is sometimes difficult for small producers to obtain. But it can be obtained by savings, by previous profits from small-scale operations, or by borrowing. The borrowing can be done if a would-be enterpriser can convince a friend or a bank that he is likely to be successful. For a government agency to supply capital to individuals to become producers would only breed favoritism, corruption, and scandalous waste.

6. True, officers or directors of big corporations can sometimes try to use the capital and man-

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agement of their company primarily to enrich themselves. Such practices can be minimized by watchful stockholders and appropriate corporate laws and law enforcement. But companies in which the practices occur extensively will soon go broke and be eliminated in favor of honestly-run companies.

7. There is no scientific way of measuring "productivity" in a service-oriented economy. Most of the current attempts to measure it rest on fallacious assumptions. The total value of output is essentially subjective, and not objectively measurable. The official GNP calculations are largely fraudulent. A short crop of wheat or corn, for example, usually sells for a greater money total than an above-normal crop. If we could produce everything anybody wanted, the national income would be zero. As nothing would be scarce, nothing could command a price.

8. It is sometimes difficult to know what injuries on the job are the fault of the individual worker and what of bad working conditions supplied by the employer. In any case, almost everywhere today the employer is legally obliged to pay "workmen's compensation" for most such injuries.

9. True, capitalism does not supply "equal" housing or "equal" pay. If we tried to do the latter, regardless of the difference between the skills and industry of different workers or even whether a man did not work at all, we would soon destroy all incentives to production and have little creation of housing or anything else.

10. There is nothing "inhuman" about capitalism itself. It does not legally compel compassion or charity on the part of private individuals, but neither does it stand in the way. Socialism assumes that nobody will help the poor unless the politicians compel him to. Capitalism is, in fact, the most "human" of all systems. It provides the greatest amount of material goods and services, both necessities and luxuries, for humanity. It supports the greatest number of human beings, and provides the more successful with a surplus above their needs capable of being turned over to the less successful, voluntarily or

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through taxation. Without capitalism, in short, most of its present detractors wouldn't be around today to denounce it.

A Flawed System

One final word. Your questions tacitly assume that capitalism is the system we are now in fact living under. We are not. We are living under what the late Ludwig von Mises called "sabotaged" capitalism. We are living under a network of government interventions that discourage or prevent capitalism from doing its work. With the "progressive" income tax, the government expropriates a crucial part of precisely the funds that would otherwise be invested in increased production and employment. By imposing minimum wage laws, encouraging coercive unionism, and subsidizing unemployment, government has brought about excessive American wage rates in many lines—making our automobile and steel industries at the moment unable to compete against foreign imports, and bringing about chronic unemployment. Having done this, the politicians denounce our domestic manufacturers for no longer being "competitive," "aggressive," or "innovative," and propose still more interventions to force them to be so. Thus anticapitalism begets still more anticapitalism.

I enclose a copy of my short pamphlet "Understanding 'Austrian' Economics" (published by the Foundation for Economic Education) which adds a list of books that I hope will increase your understanding of the workings of capitalism and its proposed alternatives.

Henry Hazlitt, a frequent contributor to *The Freeman*, has a long and distinguished career as an economist, journalist, editor, and literary critic.

His well-known *Economics in One Lesson* further answers many of the more common questions about capitalism. That book is available from The Foundation for Economic Education, Irvington-on-Hudson, NY 10533 @ $4.95 in paperback.

Also available upon request, copies of "Understanding Austrian Economics":

Single copy	no charge
3 copies	$1.00
10 or more	20 cents each

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Donald B. Billings

The Moral Case for Competitive Capitalism

What is under attack is the capitalist system; and it is attacked mainly on ethical grounds, as being materialistic, selfish, unjust, immoral, savagely competitive, callous, cruel, destructive. If the capitalistic system is really worth preserving, it is futile today to defend it merely on technical grounds (as being more productive, for example) unless we can show also that the socialist attacks on ethical grounds are false and baseless.[1]

—Henry Hazlitt

As Karl Marx noted in the *Communist Manifesto,* capitalism is a great "engine of growth," a proposition with which today few informed observers of the economic scene would disagree. Yet, the free-market system continues to be viewed as materialistic, unjust, callous, cruel and therefore immoral by great numbers of people all over the world. This is especially true among many, if not most, intellectuals. Alexander Solzhenitsyn, in a *National Review* article in 1978, acknowledged that ". . . it is almost universally recognized that the West shows all the world a way to successful economic development." However, and unfortunately, he goes on ". . . many people living in the West are dissatisfied with their own society. They despise it or accuse it of not being *up to the level of maturity attained by mankind.*" (italics added)[2] Following this line of thought, the world continues to witness attempts by supposedly beneficent dictators to remake mankind in terms of some utopian, and more often than not very vaguely specified, image. Unfortunately, societies designed from above to promote morality are rarely

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successful. The Ayatollah's Iran is an excellent example of a "spiritual intolerance which does violence to mind and body."

Indeed, totalitarian regimes frequently appeal to morality as a convenient device to assist in the subjugation of their peoples. Henry Hazlitt cites an incident, recorded in Marx's correspondence with Engels, at the communist First International in which Marx admits that "I was obliged to insert in the preamble two phrases about 'duty and right,' *ditto* 'truth, morality, and justice.' But these lamentable phrases are placed in such a way that they can do no harm."[3] In fact, as Max Eastman records, "The notion of an earthly paradise in which men shall dwell together in millennial brotherhood is used to justify crimes and depravities surpassing anything the modern world has seen."[4]

Consider the Alternatives

The morality or justice of the system of competitive capitalism, therefore, cannot be fully appreciated until the alternatives observed in the real world are evaluated. For as Arthur Shenfield reminds us, "It is a plain historical fact that the treatment of man by man became conspicuously more humane side by side with the rise of capitalism."[5]

Attitudes and policies toward the punishment of crime, treatment of women, lunatics, the feeble-minded, the lame, and in attitudes toward slavery and serfdom, the treatment of workers, changed significantly for the better during the rise of industrial capitalism. There was even an "explosion of charitable endeavor in the countries which bore the most marked impress of capitalist principle and practice." The economic system of private property, voluntary exchange and free markets brought with it, according to Shenfield, an improvement on what had gone before and very definitely an improvement over the socialist dictatorships of the twentieth century.

> For centuries in pre-capitalist Christendom men were insistently urged to lay up their treasure not in this world but in Heaven, to eschew greed and selfishness, to care for the poor, the sick, the widow and the orphan, to treat all Christians, if not others, as brothers. Yet the normal and universal treatment of man by man in every respect was so inhuman by our present standards that we would be unable to picture it to ourselves were it not that we know it to be matched in the post-capitalist socialist countries of our time. And these socialist countries are conspicuous not merely for their pervasive cruelty and oppression but also for their loud claims to be in process of building a comradely society free from greed and selfishness![6]

Following the lead of the economist Benjamin Rogge, it is in fact the case that ". . . the most important part of the case for economic freedom is not its dramatic success

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in promoting economic growth, but rather its consistency with certain fundamental moral principles of life itself."[7] For personal freedom, and therefore economic and political freedom, is not "ethically indifferent" but a necessary condition of morality. Friedrich Hayek reminds us of certain fundamental conditions of the moral life.

> It is . . . an old discovery that morals and moral values will grow only in an environment of freedom, and that, in general, moral standards of people and classes are high only where they have long enjoyed freedom—and proportional to the amount of freedom they have possessed . . . That freedom is the matrix required for the growth of moral values—indeed not merely one value among many but the source of all values—is almost self-evident. It is only where the individual has choice, and its inherent responsibility, that he has occasion to affirm existing values, to contribute to their further growth, and to earn moral merit.[8]

Morality and the Market

It appears that the free market system, in which only voluntary and mutually beneficial exchange are permitted, is a necessary condition for a moral order in which the integrity of the individual conscience is respected. Hayek points out in *The Road to Serfdom* that only:

> where we ourselves are responsible for our own interests . . . has our decision moral value. Freedom to order our own conduct in the sphere where material circumstances force a choice upon us, and responsibility for the arrangement of our own life according to our own conscience, is the air in which alone moral sense grows and in which moral values are daily recreated in the free decision of the individual. Responsibility, not to a superior, but to one's conscience, the awareness of a duty not exacted by compulsion . . . and to bear the consequences of one's own decision, are the very essence of any morals which deserve the name.[9]

"Surely," adds Hayek on another occasion, "it is unjust to blame a system as more materialistic because it leaves it to the individual to decide whether he prefers material gain to other kinds of excellence."[10] Whatever the goals of individuals, whether virtuous or not, the "vulgar calculus of the marketplace" still seems to be the most humane way mankind has found for dealing with the economic problems of scarcity and the difficult allocation of resources.

Murray Rothbard forcefully reminds us that ". . . in a world of voluntary social cooperation through mutually beneficial exchanges . . . it is obvious that great scope is provided for the development of social sympathy and human friendships." Indeed, "it is far more likely that feelings of friendship and communion are the *effects* of a regime of contractual social cooperation rather than the cause."[11]

Capitalism tends to favor those who respect the sanctity of their

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contracts because of the respect for and enforcement of private property rights. The work ethic, encouraged by the institution of private property, represents an important source of moral responsibility as well as a continuous reminder that our actions always entail costs—a pervasive characteristic of human existence. These essential ingredients of a free market order, Arthur Shenfield tells us, define a set of social institutions which encourages mutual respect for each and every individual.

> What we want above all for ourselves, and which therefore we must accord to our neighbor, is freedom to pursue our own purposes . . . As a corollary to this freedom we want others to respect our individuality, independence, and status as responsible human beings . . . This is the fundamental morality which capitalism requires and which it nurtures. It alone among economic systems operates on the basis of respect for free, independent responsible persons. All other systems in varying degrees treat men as less than this.[12]

Peaceful Trade

The processes by which we satisfy human wants through social cooperation, do not, of course, exhaust the purposes to which individuals aspire. The search for personal happiness and inner peace must be found within the individual alone. Nevertheless, mankind's social relationships are generally far more peaceful under a system of private property and free trade. The period between the Napoleonic Wars and the first World War, the heyday of competitive capitalism, represented a century relatively free of the brutality of war.

Furthermore, Shenfield, Hayek and others remind us that competitive capitalism was the first social system in human history to direct man's desire to become rich to the peaceful supply of greater quantities of goods and services for his fellow human beings, especially greater abundance for the working class and the poor. And remember, Shenfield warns us, "The alternative to serving other men's wants" through voluntary exchange "is seizing power over them." Where socialism has prevailed it has invariably meant not only lower living standards for most people "but also their reductions to serfdom by the new privileged class of socialist rulers."[13]

The case for the morality and justice of the system of capitalism rests on the intimate and complementary connection which exists between private property and voluntary arrangements *and* the sovereignty of the individual over his own life. In fact, "one might say that capitalism, far from dehumanising man, allowed him at last to assume the full individuality which Christianity had always accorded him as the pos-

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sessor of a distinctive moral conscience." Paul Johnson reminds us, however, that ". . . we tend to take the concept of individuality for granted. Yet it is a comparatively modern idea—no older than capitalism; scarcely older than the Industrial Revolution."[14]

Free and Responsible

The "dawn of conscience," that point in history in which individuals were first argued to be morally free and therefore responsible for their actions, appeared in Egypt and was borrowed and developed by the Jews. Jesus and his interpreter, St. Paul, in the New Testament outlined a view which recognized the unique personality of each human being. It is essentially an individualistic view of mankind in which, for the first time, the individual's soul is the most important thing about him. Christianity provided an environment in which individuals, to gain salvation, made choices from a position of free will.

Not only did the Church find that individual souls were worth saving, but Christianity also "implanted the concept of the rule of law," and contributed importantly to the establishment of the idea of freehold property and the land deed in the western world. Admittedly, these contributions were largely to protect the Church and its institutions and property from the power of the State. But over time the principle of the rule of law and the private ownership of property were progressively expanded to the relationships between individuals. "The connection between Christian morality and capitalism thus centers essentially around the role and importance of the individual," according to Paul Johnson:

> More than to any other force, then we owe the acknowledgement of our individuality to capitalism, . . . And individualism is rooted in the Judaeo-Christian doctrine of conscience and free will. Free will implies choice: the moral function of society, the way in which it best serves the moral needs of the individuals who compose it, is when it facilitates the process of choice, permits consciences to inform themselves, and so offers the individual the greatest possible opportunity to fulfill his part . . . That, essentially, is the moral basis of capitalism.[15]

We conclude, therefore, that the system of free and open markets is most conducive to the perfection, or at least improvement, of man's free will and tends to generate and make possible moral behavior. While it is admitted that society itself cannot be moral or immoral, only individuals are moral agents, it would appear, following the arguments developed by Arthur Shenfield, that an economic system, "if its essential characteristics on balance positively nurture or reinforce moral or immoral individual behavior, it is a moral or immoral system *in its ef-*

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fects." (italics added)[16] Where justifiably acquired property rights are defended, and where contracts are enforced, and where the rule of law applies, then "the voluntary nature of capitalist transactions propels us into respect for others."

For John Stuart Mill, justice is likewise a moral issue:

> Whether the injustice consists in depriving a person of a possession, or in breaking faith with him, or in treating him worse than he deserves, or worse than other people who have no greater claims, in each case the supposition implies two things—a wrong done, and some assignable person who is wronged . . . Justice implies something which it is not only right to do, and wrong not to do, but which some individual person can claim from us as his moral right.[17]

"Justice, in brief," Henry Hazlitt maintains in *The Foundations of Morality*, "consists of the social arrangements and rules that are most conducive to social cooperation." Therefore we conclude that a system of institutional arrangements called "capitalism" (a disparaging reference for many people, the reader is reminded) is unquestionably more consistent with justice in this sense than any alternative set of social arrangements even conceivably available to us. The obviously immoral character of the socialist dictatorships in Poland, Cuba, East Germany, the Peoples Republic of China, the Soviet Union, or for that matter the right-wing fascist dictatorships which abound, where the most elementary human freedoms are supressed and where millions of human beings have been murdered in the name of a new social order, documents the case for the private property, decentralized market system.

The great French economist and social critic Frederic Bastiat, writing in the nineteenth century, captured what would be the desirable characteristics of a truly just and moral order. He asked the question:

> Which countries contain the most peaceful, the most moral, and the happiest people? Those people are found in the countries where the law least interferes with private affairs; where the government is least felt; where the individual has the greatest scope, and free opinion the greatest influence; where the administrative powers are fewest and simplest; where taxes are lightest and most nearly equal; . . . where individuals and groups most actively assume their responsibilities, and, consequently, where the morals of . . . human beings are constantly improving; where trade, assemblies, and associations are the least restricted; . . . where mankind most nearly follows its own natural inclinations; . . . in short, the happiest, more moral, and the most peaceful people are those who most nearly follow this principle: although mankind is not perfect, still, all hope rests upon the free and voluntary actions of persons within the limits of right; law or force is to be used for nothing except the administration of universal justice.[18]

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In light of these arguments by Hazlitt, Shenfield, Bastiat and the others, a very interesting and important question remains to be asked. Why is it that a system of social organization which has produced historically unprecedented increases in living standards in those countries where the principles were practiced *and* which simultaneously did so much to reduce man's inhumanity to man during its ascendancy has come to have such a low standing in the minds of so many millions of people? Hayek is right when he insists that we must once again make the study of freedom an exciting intellectual issue.

—FOOTNOTES—

[1]Henry Hazlitt, *The Foundations of Morality* (Los Angeles: Nash Publishing Co., 1964), p. 302.

[2]Alexander Solzhenitsyn, "A World Split Apart," *National Review*, July 7, 1978, p. 839.

[3]Hazlitt, p. 340.

[4]*Ibid.*, p. 341.

[5]Arthur Shenfield, "Capitalism Under the Test of Ethics," *Imprimis* (Hillsdale College: Michigan), December 1981, p. 4.

[6]*Ibid.*, p. 4.

[7]Benjamin Rogge, "The Case for Economic Freedom," *The Freeman*, February 1981, p. 86.

[8]Hazlitt, p. 322.

[9]Friedrich A. Hayek, *The Road to Serfdom*, cited in Leslie Snyder, "Justice and Freedom," *The Freeman*, March 1980, pp. 186–187.

[10]Quoted in Hazlitt, p. 323.

[11]Murray N. Rothbard, *Man, Economy and State* (Los Angeles: Nash Publishing Co., 1962), p. 86.

[12]Shenfield, p. 6.

[13]*Ibid.*, p. 5.

[14]Paul Johnson, "Is There a Moral Basis for Capitalism," *PAIDEIA*, Spring 1980, p. 3.

[15]*Ibid.*, p. 3.

[16]Shenfield, p. 4.

[17]Snyder, p. 183.

[18]*Ibid.*, p. 187.

IDEAS ON LIBERTY

The Case for Economic Freedom

THE DOCTRINE of man held in general in nineteenth century America argued that each man was ultimately responsible for what happened to him, for his own salvation, both in the here and now and in the hereafter. Thus, whether a man prospered or failed in economic life was each man's individual responsibility: each man had a right to the rewards for success and, in the same sense, deserved the punishment that came with failure. It followed as well that it is explicitly immoral to use the power of government to take from one man to give to another, to legalize Robin Hood. This doctrine of man found its economic counterpart in the system of free enterprise and, hence, the system of free enterprise was accepted and respected by many who had no real understanding of its subtleties as a technique for organizing resource use.

BENJAMIN A. ROGGE

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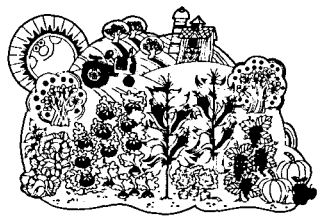
William H. Peterson

Farm Policy— NOW WHAT?



PRESIDENT REAGAN proclaims his new payments-in-kind (PIK) program to give farmers surplus grain plus cash if they cut production substantially in the next two years as "highly innovative." Is it really? FDR had a similar program for cotton farmers, and President Kennedy had much the same scheme for feed-grain producers. Neither the Roosevelt nor Kennedy plan proved effective.

Indeed, more than a half-century of aggressive farm intervention costing hundreds of billions of dollars in subsidies spells out a record of unremitting failure and frustration, with the farmers themselves the ultimate losers.

In 1929, for example, President Hoover set up the Federal Farm Board to stabilize crop prices. By the end of his administration the Board had gone through more than $300 million of its $500 million in operating capital, with nothing to show for it but record farm foreclosures. Every time the Board had a modicum of success, production would shoot up, foreign markets would fade away, and heavy inventories would overhang the market like the sword of Damocles. Soon President Hoover recommended the next logical step of price intervention: production restrictions—withdrawing land from cultivation, slaughtering young animals, plowing under crops. President Roosevelt and his successors put these and other restrictions into practice.

Thus the pattern for some five decades of farm intervention was set: production incentives such as price supports and crop insurance, on the one hand, and production curbs such as acreage allotments and marketing quotas, on the other. Generally the production incentives have won, burdening the government and taxpayer with huge stockpiles of food

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and fiber over the years. The stockpiles, in turn, have forced the government into such welfare ventures as food stamps, school lunches, senior citizen "nutritional programs," "Food for Peace" foreign giveaways, and so on.

The rub with modern farm policy, then, is its useless and quite irrational attempt to repeal the law of supply and demand—to reinvent the wheel. The unhampered price mechanism, in other words, ever pulls supply and demand toward equilibrium, leading to optimum efficiency and economic growth and assuring that whenever shortages or surpluses do emerge they are fleeting and short-lived.

The further rub is that *the farmer to be saved wasn't.* Ultimately he was burned and he, like his forebears, quit the farm for other pursuits, causing a massive change in the composition of the American population. The *1981 Statistical Abstract of the U.S.* tells the story:

	Farm population (millions)	Per cent of total population
1930	30.5	24.9
1940	30.5	23.2
1950	23.0	15.3
1960	15.6	8.7
1970	9.7	4.8
1980	7.2	3.3

In a like way, American agriculture, notwithstanding the lure of subsidies, offers fewer and fewer job opportunities as farmer-entrepreneurs have automated their production. Note how the number of full-time farm jobs, including those of farm operators, their family members doing farm work, and hired hands has plummeted over a 50-year span:

	Farm employment (millions)	Per cent civilian labor force
1930	12.5	25.8
1940	11.0	19.8
1950	9.9	15.9
1960	7.1	10.2
1970	4.5	5.4
1980	3.7	3.5

But as the number of farms and farm employment has dropped in this period the size of farms has nearly tripled in entrepreneurial response to the economies of scale over the years:

	Farms (millions)	Average farm size (acres)
1930	6.5	151
1940	6.3	167
1950	5.6	213
1960	4.0	297
1970	2.9	374
1980	2.4	429

Moreover, despite all manner of government controls, farm produc-

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tivity has generally raced ahead of nonfarm productivity in recent decades. From the 1950–1954 period to the 1975–1979 period, for example, the annual average yield of corn leaped from 39.4 to 95.2 bushels per acre, wheat from 17.3 to 31.4 bushels per acre, potatoes from 15,100 to 26,200 pounds per acre, milk from 5,400 to 11,000 pounds per cow, and eggs from 181 to 236 per laying chicken.

In the same periods, annual average manhours necessary to produce each 100 pounds of chicken broilers dropped from 2.4 to .1, reflecting enormous acceleration in automated broiler production and a reduction in manhour requirements by 96 per cent in a 25-year stretch. During this same period, turkey production automation was not quite so rapid. Here, 6.8 manhours were required to produce each 100 pounds of turkeys, on an annual average basis, in the 1950–1954 period, against only .5 manhours in the 1975–1979 period, thereby reflecting a 93 per cent manhour reduction in turkey production.

About the only winners I can find in America's farm picture are the farm politician and the farm bureaucrat. The bureaucrat really farms the farmer. While the number of farms and the farm population have plummeted, the number of employees at the Agriculture Department has grown like weeds. In 1930 there were 26,050 employees, 98,694 in 1960, and 129,139 in 1980.

Clearly depopulation of the farm sector has weakened the farm bloc but only relatively. Last November all 21 Democratic members of the House Agriculture Committee seeking re-election held on to their seats while the GOP saw 5 of their 19 members defeated, including ranking member William D. Wampler of Virginia and second-ranking Paul Findley of Illinois, a key Administration supporter on farm bills. So regardless of the irrationality and colossal waste of modern farm policy, the immediate outlook is for more of the same.

But the longer-run outlook seems saner. As farms more and more come into stronger hands and grow in size, farmers will tend to demand more of a no-nonsense farm policy. Then increasingly unhampered farm entrepreneurship can play a more constructive role for the farmer, the consumer and the economy. For today's farmer, after all, is still a private property-holding, technologically astute, business entrepreneur. And when he becomes numerically smaller still and hence no longer fair game for politicians and bureaucrats, when, in other words, he becomes just another unsubsidized businessman (if in dungarees), he will thrive.

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Hans F. Sennholz

Benefit Mandates Cause Unemployment

MOST PEOPLE expect more from their work than wages. They seek additional benefits, such as a sense of purpose, accomplishment, appreciation, companionship, etc. They desire all sorts of things in exchange for their labor. In the broadest sense all these things are "fringe benefits."

Psychic benefits have great economic significance as they may affect a person's spirit, disposition, and attitude. They influence his will and power of work, his contribution to the production effort. A wise employer is keenly aware of the importance of psychic benefits which he grants with great generosity. They never impoverish the giver, but always enrich the lives of those who receive them as well as those who confer them. They cannot be calculated in dollars and cents although they affect personal productivity and income.

Fringe benefits appear on the production ledgers when they cost money. They provide additional remuneration to employees in the form of vacation and holiday pay, sick pay, the cost of pensions, and employer contributions to various benefit systems. These extra costs of labor are frequently overlooked in popular discussion, which is preoccupied with hourly, weekly, or monthly wages and salaries.

To obtain a true measure of production costs, businessmen must take all costs into account. To consider some costs and overlook others is to invite losses and failure. Employers cannot disregard the costs of fringe benefits, which amount to sizable proportions of total labor costs. They must be ever mindful of the fact that every penny of labor cost must come from the productive efforts and contributions of the workers themselves. There are no gratuities or

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transfer payments in the production and distribution process. Every participating factor receives an income that corresponds to the value of its productive contribution.

Many workers, unfortunately, look upon fringe benefits as "employer gratuities" that are taken out of business profits. There is no hourly, weekly, or monthly accounting and reporting of fringe benefit costs, which tends to obscure the fact that they are labor costs just like wages and overtime pay. Actually, it does not matter how the costs are allocated among the various benefit accounts, as long as the total costs of labor do not exceed the value of labor production. If total labor costs, for any reason, are made to exceed the value of a worker's contribution, he is inflicting losses on his employer. He becomes "destructive" rather than productive, a "liability" rather than a productive partner, he becomes a candidate for "disemployment."

Labor Legislation

The common failure to view fringe benefit costs as labor costs probably stems from the sphere of politics where transfer payments are popular devices. Government is made to serve as a giant transfer agency that seizes income and wealth from some people and allocates them to others as "entitlements" and "benefits." If legislators can bestow gratuities through government, why should they not grant favors through mandates to business? No new taxes need to be levied, no costly bureaucratic apparatus of transfer needs to be established, the legislators merely issue a mandate and government agents enforce it.

The mandate of costly fringe benefits draws ideological strength and support from the precedent of past labor legislation that aimed at improving working conditions. Beginning in the 1830s and 1840s, some state laws regulated the number of hours worked by children. During the 1920s it became popular for state governments to regulate the working conditions for women. In 1938, finally, the federal government assumed the lead with the Fair Labor Standards Act, which not only imposed minimum wage rates but also provided for a 40-hour week, allowing for overtime work if paid at time-and-one-half.

Public opinion is fully convinced that all labor improvements are an achievement of the combined efforts of labor legislation and union activity. It credits humanitarian legislators and courageous union leaders not only with the phenomenal rise in wage rates, but also with the reduction of daily hours of work, the disappearance of child labor, the limitation of woman labor, and many other results. If legislation and unionism did have such powers in

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the past, they must have similar powers in the present. With courage and dedication they must be able to exact ever greater benefits from reluctant employers.

Persistent Political Errors

Unfortunately, there are political errors which, once they sway public opinion, become public virtue and policy. They may lend an age its singularity and hallmark that persist for many generations despite their ominous consequences. When future historians research our age they cannot help but be confounded by our undaunted faith in labor legislation and unionism that give our age a conspicuous characteristic: mass unemployment. They will be mystified by our steadfast refusal to see that neither government nor unions do have the coercive powers to improve working and living conditions. They did not have them during the 19th century, and do not have them in the 20th. The remarkable improvements were brought about by the formation of productive capital that provided labor with ever more efficient tools and equipment. Labor legislation and labor unions tend to shackle productivity, hamper output and, therefore, keep society poorer than it otherwise would be.

Child labor laws and regulations of women's working hours usually followed the improvements brought about by capital investment and productive technology. The legislators merely sanctioned what already had taken place. But in true political fashion they were always quick to claim full credit for the achievements of others, especially countless investors and entrepreneurs. Their vainglorious pretensions unfortunately persuaded many gullible followers.

In some cases the laws and regulations actually pushed further than conditions allowed, which caused disruption and stagnation. It harmed everyone, but especially those individuals it meant to benefit. It drove many into idleness and poverty, or led them to ignore the law that denied their freedom to work. The underground economy was born on the very day the first restrictive labor law went into effect.

To raise the costs of labor by benefit mandate is to set into motion an array of adjustments and readjustments that redistribute the burden among all market participants. The reaction manifests an important distinction between two main categories of labor costs:

1. Contractual employer payments to employees or on their behalf. They include not only all items of cash payment and supplementary remuneration payable directly to employees, but also contractual expenditures on their behalf, including contributions to pension and other funds.

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2. Mandated benefits that are exacted by political force on behalf of employees, including contributions to Social Security, unemployment and workmen's compensation, disability benefits, and several others. They are meant to be "transfer payments" taken out of employer profits.

In the world of economic reality, both categories of benefits—the contractual remuneration and the mandated benefits—are derived from one and the same source: employee effort and production. Backed by the state apparatus of force the mandated benefits take precedence over the contractual benefits, which must adjust continually to the former, acting as a residual that can be paid after the mandates have been satisfied. The adjustment is a market process that shifts the costs of production to the factors that incur them. In particular, it shifts the costs of mandated benefits to the very beneficiaries by forcing them to suffer reductions in contractual remuneration. The shifting is painful in the short run, but beneficial in the end. It corrects the disarrangement prompted by the government intervention.

A Crucial Difference Between Old and New Benefits

The shifting process is the source of much economic confusion. Some observers look only at the adjustment process, others only at its consequences; some reflect only on old government intervention, others only on new laws and mandates. The distinction between the two rests on strict theoretical analysis and can be defined precisely. Old intervention is that government restriction or interposition to which the economy has fully adjusted. And we speak of new intervention when the economy has not yet adjusted to the new data, or is in the process of adjustment. The difference is crucial in any appraisal of the effects of government-mandated benefits.

Legislation or regulation that aims to benefit some people at the expense of others, may be successful in the short run, but rarely is so in the long run. It causes an immediate reaction and readjustment of price, wages, and other costs that shift and redistribute the burden to all market participants. The costs of mandated labor benefits imposed on employers are shifted in time to the workers themselves. The shifting is a short-run process, the final burden to workers a long-run effect.

A boost in Social Security levies, unemployment taxes, Workmen's Compensation Insurance levies, Occupational Safety and Health Act costs, or Employee Retirement Income Security Act premiums, constitutes a boost in labor costs, which reduces the profitability of business—a short-run effect.

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Employers may react by seeking to offset the mandated increase in costs with reductions in contractual labor costs, such as take-home pay and fringe benefits. But such an offset may be resisted and rejected by the other contract party, the workers. After all, politicians and government officials have told them time and again—and the benefit law expressly stipulates—that employers must grant the benefits gratuitously. The law may even affix fines and imprisonment for employers who neglect or refuse to provide the benefits. Therefore, it is rather unlikely that employers would openly seek to reduce contractual labor benefits in reaction to increases in mandated benefits.

How Inflation Shifts the Burden of Employment Costs

In periods of inflation when periodic wage adjustments are made, employers may be rather successful in hiding the needed offset by offering lower raises than they otherwise would. In a year when inflation reduces the purchasing power of the dollar and, therefore, the real costs of labor by 15 percent, an employer may, without much resentment on the part of his employees, grant a 10 percent wage adjustment and allocate more funds to Social Security, unemployment levies, and other mandated costs. His real costs of labor may not rise at all. But his employees now must forgo a part of their real incomes in favor of their "gratuitous" benefits.

Other employers yet may succeed in offsetting mandated boosts in labor benefits by leading and exhorting their workers to greater effort and productivity. But such offsets are rather difficult. Workers may resist the exhortations openly aiming at shifting the burden of their benefit "entitlements" from employers to themselves. Most such offset attempts, therefore, may prove to be futile, which forces employers to brace for higher production costs.

Rising labor costs, like any other rise in production costs, may have different effects on three distinct groups of enterprises found in nearly every industry: a few are profitable, many are marginal, and a few submarginal.

When government mandates higher labor costs, the few employers who were earning *genuine profits* are forced to curtail their expansion or modernization projects. They may not need to discharge any workers, but may be reluctant to add more. The *marginal employers* who were just breaking even, earning the going rate of interest on the capital invested, will be made "submarginal" by the boost in labor cost. Their yields now fall below the minimum rates needed to attract and preserve the necessary capital. They are forced to curtail their opera-

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tions, close loss-inflicting plants, stores, or departments, and lay off some workers. The *submarginal employers,* who were earning meager returns or even suffering losses before the mandated cost increases, are further encumbered by the boost, which may push them over the edge into liquidation or bankruptcy. Output declines and the supply of goods and services is diminished. There is business stagnation—a short-term effect of the newly mandated labor benefits.

The Market Adjusts

The stagnation is keenly felt in many labor markets that lack the flexibility and mobility for the needed adjustment. It gives rise to mass unemployment that exerts a powerful pressure toward lower labor costs—until they have fallen to the rates allowed by the market. If the labor market is permitted to adjust and government abstains from any new mandates that raise labor costs, unemployment will gradually diminish until everyone willing to work can find his job.

But the long-term effects of the labor mandate will be felt as long as it remains in effect. They are less conspicuous than the short-term effects and difficult to demonstrate. After all, who can perceive that the mandated costs have been offset by a reduction in contractual compensation, and that the worker himself now is laboring for every penny of benefit exacted from his employer? Who can perceive that he alone is paying for his Social Security benefits, his unemployment compensation, Workman's Compensation, OSHA and ERISA benefits?

This inability to perceive the painful shifting process that allocates the costs of benefit mandates to the workers themselves may explain why there are so many advocates of ever more government intervention. They point at old benefits imposed ten or twenty years ago and fail to see any ill effects in the present. They have forgotten the months and years of painful adjustment, and never learned that, in the end, the workers themselves are bearing all costs.

Whether government intervention is old or new, it constitutes a substitution of political coercion for economic freedom of choice, and the rule of politicians over consumers, employers and workers. It is a substitution that rests solely on gross deception and economic ignorance. Surely, most American workers and their union agents are convinced that their benefit entitlements from unemployment compensation to ERISA bounty are exacted from employer profits. Therefore, they are applauding politicians who promise and legislate ever more expensive gratuities. If they actually knew that there are, and can be, no gratuities

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in production, that every penny of benefit is taken out of their own pockets, they would probably rise in anger and call an immediate halt to the mandates.

Social Security

The benefit mandates of the 1960s and 1970s did not differ in substance from the labor mandates of the 1930s. Both forcibly raised labor costs, created disruptions in the production process, and in the short run, caused mass unemployment. In the long run, when all price and cost adjustments had run their course, they lowered the contractual remuneration of the intended beneficiaries. In the case of Social Security, which provides old-age, survivor, and disability benefits, as well as hospital insurance, government injected an additional transfer feature. It conferred generous benefits on the retirees and exacted the needed funds from the working people, many of whom were forced to suffer both the short-run and long-run pains of adjustment, that is, unemployment in the short run and lower take-home pay in the long run.

Old-age, survivors, and disability insurance covers almost all jobs in which people work for wages or salaries, as well as most work for self-employed individuals. The system is financed by payroll taxes levied on an employer's taxable payroll; half the tax is deducted from the employees' wage, and one-half is taken from employer income. While the first half merely reduces the employee's take-home pay, the second half actually raises labor costs and thereby reduces the demand for labor. It causes unemployment.

Small increases in payroll taxes imposed on employers affect all workers, but "disemploy" only a small number. Employers may be able, through managerial effort and leadership, to make labor more productive and thus cover the additional expense. If profits permit, they may introduce more productive tools and equipment that raise the productivity of labor. Or, inflation may reduce the real cost of labor, which may permit employers to pay higher payroll taxes—provided that contractual labor costs are not indexed, which would prevent the decline in real cost. Where cost adjustments are not feasible, the boost in payroll taxes, no matter how small, must have disemployment effects. A mere rise of one-tenth of one percent of labor cost may cause the demand for labor to decline by one-tenth of one percent or more, which in the American labor market would mean unemployment for 100,000 workers or more.

Boosts in Taxes

The frequent boosts in Social Security taxes have not always been small. In some years Congress raised

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the rate, in others the maximum wage base. At times both were boosted substantially. In 1950, the employer levy rose by 50 percent, in 1954 by 33 percent, 1959 by 27 percent, 1966 by 59 percent, 1973 by 35 percent, 1979 by 31 percent, 1981 by 24 percent.[1] But no matter whether the boosts were large or small, they all constitute additions to labor costs. The magnitude of the boost merely determines the severity of the adjustment process and the measure of reduction of contractual benefits.

Social Security tax boosts obviously are not the only cause of rising unemployment; there are many other cost factors that may cause labor to become uneconomical and unemployable. In the depth of a recession, both federal and state governments may boost the unemployment insurance tax on employers, which raises labor costs and thereby further reduces the demand for labor. It inevitably aggravates and prolongs the recession. But it is also conceivable that the cost mandates of government are partially or completely offset by inflationary policies that tend to lower the real cost of labor. When one branch of government raises labor cost and another lowers it, it is difficult to foresee which branch will prevail in the end. The offsetting process itself is very disruptive as it affects different employers unevenly and disproportionately.

It is illogical and irrational to defend the boosts in payroll taxes with explanations and descriptions of the urgent needs of elderly people. Surely, their needs and wants play an important role in politics, which has made the Social Security System the largest transfer system ever devised. But regardless of want and need, payroll taxes levied on behalf of the elderly or for any other reason do raise the cost of labor, which in turn lowers the demand for labor. In the short run, they may cause unemployment; in the long run, they tend to lower contractual wages and benefits by the amount of the tax boost.

Unemployment Compensation

Before the Great Depression public opinion had lumped the unemployed and the unemployable together and made them the objects of charity. During the 1930s, under the influence of changing economic thought, public opinion began to adopt the concept that unemployment is a fault of the competitive private-property system, and therefore, a serious concern of government.

Unemployment insurance is based on the popular notion that the system makes a certain amount of unemployment inevitable. If it cannot be prevented, at least the workers and their families must be protected from the loss of income. And since it

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is not the fault of either employers or workers, but the natural consequence of the free enterprise system, the costs should be shared by all. In most countries, unemployment insurance is financed by contributions from workers, employers, and government.

In the United States, the Roosevelt New Deal went much further. It adopted the theory that employers, as the principal beneficiaries and advocates of the enterprise system, can control the rate of unemployment inflicted on workers. Therefore, they alone must pay the unemployment tax levies. The rates were made to vary in accordance with the amount of unemployment that is attributed to the individual firm. Some employers may achieve comparatively low rates of taxation, others must pay higher rates, each based on his "experience rating." The variation in tax rates is supposed to exert a restraining influence on employers and induce them to stabilize employment.

A Counterproductive Burden Upon the Workers Themselves

This New Deal theory of unemployment and the unemployment compensation system built thereon, have inflicted, and continue to inflict, incalculable harm on millions of American workers. When, for any reason, business turns down and unemployment rises, the payroll taxes imposed on employers increase the cost of labor, which further reduces the demand for labor and worsens the unemployment. The tax burden is highest on employers who suffer most severely from the business downturn, which keeps their labor costs up and their demand for labor down. In a lengthy recession, the tax levies are boosted substantially, which tend to aggravate and prolong the recession. In fact, it would be difficult to devise a more counterproductive social program than the unemployment insurance tax levied on employers.

Unlike Social Security, which is entirely a federal program, the unemployment compensation system is a joint federal-state effort. The system was created by the Social Security Act in 1935, which imposed a payroll tax on all employers with eight or more employees in "covered" employment. The Act permitted an offset of 90 percent of the tax if the employer paid unemployment insurance taxes under a state law. This offset provision soon induced every state to enact its own unemployment insurance laws.

The system now covers about 97 percent of wage and salaried employment. Its outlays amounted to $25.2 billion in 1982 and are estimated to exceed $36 billion in 1983. Regular benefits (usually 26 weeks) are financed by state taxes on employers. State and federal adminis-

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trative costs are financed by a federal tax on employers. In any state where the unemployment rate exceeds 5 percent for 13 consecutive weeks, the benefits are extended for another 13 weeks. The extended benefits are financed one-half from state taxes on employers and one-half from the federal tax on employers.[2] A temporary program, Federal supplemental compensation (FSC), pays additional weeks of benefits to workers who exhaust their regular and extended benefits. As originally enacted, it provided for 10 additional weeks of benefits which were promptly extended to 16 weeks. Altogether, unemployed workers are entitled to 55 weeks of full benefits.[3]

The Growing Burden of Unemployment Tax Rates

Under the Federal Unemployment Tax Act, as amended by the Tax Equity and Fiscal Responsibility Act of 1982, the federal tax rate is 3.5 percent on the first $7,000 paid to each employee of employers with one or more employees. The rate is scheduled to rise to 6.2 percent in 1985. The law allows a credit of up to 2.7 percent for taxes paid under state unemployment insurance laws, which leaves the federal share at 0.8 percent of taxable wages. The states are required to meet their own unemployment insurance costs. But they are permitted to borrow funds, interest-free, from the federal government. During lengthy recessions, when the federal government can be expected to extend the duration of benefits, a large number of states is forced to borrow the needed benefit funds. The heavy payouts of benefits and the rising debt then force the states to raise both the tax base and tax rates on employers. [4] Some states levy an additional "subsidiary" or balancing tax on all employers when the state's unemployment compensation fund is low.

Unemployment insurance taxes represent a relatively small burden, less than one-third of the other Social Security levies. Until 1980 they averaged only 1.2 percent of total wages, but have been rising steadily ever since. As a proportion of net profits they may amount to large sums that lower profits substantially. During years of recession, when many businesses are operating without a net profit or even suffering losses, the unemployment insurance taxes are keenly felt. And as a proportion of labor cost for new employees who may prove to be only temporary, they may be utterly prohibitive. A worker who earns $5,000 in wages and then draws $2,500 in unemployment benefits, may cost his employer $7,500, which on a per-hour basis amounts to time and a half.

It is significant that the industrial states in the North and Northeast are the high-tax states, which also suffer from high rates of unemploy-

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ment. Deep in debt to the federal government, they must levy such a high average tax on employers that little room is left for experience rating. Michigan exacts as much as 10.5 percent on $8,000 of taxable wage base; Minnesota and West Virginia charge 7.5 percent. Several states have lifted their tax bases considerably above the federal level: Puerto Rico taxes all wages, Idaho and Utah levy their rates on $14,400 of taxable income. Such exactions no longer constitute a small burden on the workers who ultimately must bear the costs through lower take-home pay and lower contractual benefits. And, worst of all, while the levies are rising they face the intense danger of disemployment.

Subsidizing Unionized Industries

Taxation according to experience rating, which is so popular with full-employment planners, actually may intensify the disemployment pressures. If the American automobile industry, steel industry, construction industry, the garment industry of New York, or any other unionized industry, were taxed to pay their full unemployment insurance costs, labor costs would be significantly higher, which would force many employers to go out of business. Therefore, state governments never dare to subject these industries to experience ratings. Instead, they are placing heavier tax burdens on all other industries, forcing them to "subsidize" the depressed industries. In the end, workers throughout the state must suffer lower net wages so that the army of unemployed from the unionized industries can be supported appropriately.

The significance of unemployment compensation must be sought not only in the rising burden of taxation that is limiting the demand for labor, but also in the benefits that are discouraging many workers from seeking employment. A Detroit automobile worker or Pittsburgh steel worker who loses his $40,000 job ($20 per hour) surely faces serious problems of readjustment to $10,000 in regular unemployment compensation, extended benefits, and supplemental compensation. But it is unlikely that he will seek other employment. His job opportunities at these union rates are non-existent outside the fold of his union shop. His labor productivity in the open market as a semiskilled worker probably does not exceed his rate of unemployment compensation, which makes it unlikely that he will look for employment as long as the benefits continue.[5]

Workman's Compensation, OSHA, ERISA, and EEOC

The *Workman's Compensation laws* in effect in all states hold employers liable for injuries suffered by

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workmen regardless of cause. They eliminate the element of legal negligence that is basic to Common Law, and establish the principle of "*employer liability without fault.*" They require employers to insure against potential financial liabilities to injured workers. In many states, the insurance may be provided by private insurance companies, in some states only by state-operated insurance funds. In a few states employers may bring proof of their financial ability to carry their own risk and provide "self-insurance," for which ordinarily only very large firms can qualify.

The compensation system developed after 1917 when the U.S. Supreme Court agreed to the constitutionality of "employer liability without fault." Until the 1970s its costs rarely exceeded one percent of payroll despite increases in dollar payments and extended coverage. But they began to rise significantly after 1970, when the Occupational Safety and Health Act (OSHA) largely ignored the workers' role in accident and disease prevention and placed new demands on employers. Under the influence of OSHA thought and recommendation, the states substantially changed their workers' compensation laws. Traditional exemptions for farm workers and domestics were eliminated, small firms were included, more work-related diseases were covered, and, above all, the benefits paid to workers were increased substantially.

A National Commission established by OSHA to examine the state compensation systems recommended a wide variety of reforms that would multiply the expenses and make the federal government the compliance guarantor. They would deny employers the right to appeal workman's compensation agency decisions in court—except on questions of law. They would authorize the workman's compensation administrator to regulate attorneys' fees. They would establish a "retroactive benefit fund" that would adjust benefits for past inflation and bring them up to "current levels." In 84 reform proposals[6] the National Commission is pointing at the compensation system of the future. The message is clear: employers and workers beware!

Safety and Health Standards and Their Enforcement

The Occupational Safety and Health Act of 1970 requires of all employers that every job must be "free from recognized hazards that are causing or likely to cause death or serious physical harm." To that effect it directed the Secretary of Labor to establish an administration and adopt safety and health standards for all enterprises engaged in interstate commerce, except federal, state, and local governments. Em-

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ployers are penalized if an unsafe condition has been discovered and cited by an OSHA inspector and the employer neglected to correct it in a specified time.

The standards established and enforced now cover 800 pages in the Code of Federal Regulations and number some 4,400. They range from 140-odd regulations pertaining to the use and construction of portable wood ladders to dozens of regulations on workers' sanitary facilities. Do OSHA standards have a marked effect on the injury rate? According to many serious studies, they do not. Most injuries result from some behavioral problem or transitory hazard over which employers have little or no control. Only relatively few injuries involve a permanent physical hazard under employer control.

Notwithstanding OSHA and its army of inspectors, employers do not determine the levels of physical hazard in factories or workshops, nor do they ultimately bear the costs and reap the benefits of added safety. In the competitive enterprise system each factor of production must bear all costs incurred by its employment. Labor must bear all costs incurred on its behalf, whether they are contractual or mandatory, wages or fringe benefits, employee lavatories or cafeterias, earplugs or safety belts. Employers merely act as middlemen between workers willing to render a service at a wage and consumers willing to pay for the product or service.

Allocating Costs and Benefits

Through buying or abstaining from buying, consumers determine the sum total of costs which a businessman may incur in the production process. For its participation and contribution, labor receives its full share of the sum total. But workers determine how their share of costs, which constitutes their wages and benefits, is to be distributed among the several methods of compensation. They make this determination, without talking or bargaining, through their offers on the labor market. Businessmen competing for labor must give heed to the worker preferences or face higher labor costs.

If more workers prefer to offer their services to employers with greatest possible job safety, their wage rates tend to decline, granting profits to the safety-minded employers. Other businessmen competing for labor would rush to imitate the former in order to remain competitive in the labor market. If more workers choose higher wages, but are willing to assume greater on-the-job risk, they flock to employers offering higher pay but lower safety expenditures. Alert employers immediately perceive the worker preference that is visible in the employment cost of the last worker needed, the "marginal worker." To ignore him is to face

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higher labor costs and invite business losses. In short, as businessmen receive their production orders from their customers, who set narrow limits to labor expenditures, so they receive their instructions on the distribution of labor benefits from their workers.[7]

High Costs of Compliance

It is difficult to estimate the labor costs of compliance with OSHA regulations. A 1974 survey by the National Association of Manufacturers (NAM), which is probably exaggerating the case, estimated the costs for small firms (up to 100 employees) at $35,000, for firms with 101–500 employees at $73,500, and for firms with 501–1000 employees at $350,000.[8] Small businesses applying for loans from the Small Business Administration requested an average of $200,000 in order to comply with OSHA regulations. But no matter what the actual costs of compliance proved to be, and continue to be, they probably amount to tens of billions of dollars. OSHA contributed significantly not only to the rising unemployment and decline in real wages, but also to the extraordinary rise in goods prices throughout the 1970s.

Since the birth of the transfer state older Americans forcefully asserted their political rights to transfer benefits from younger Americans. They made the support for the elderly a primary objective of government policies—from subsidized health and housing, to special tax allowances, improved old-age benefits, and the *Employee Retirement Income Security Act of 1974* (ERISA). The act meant to make it easier for them to qualify for pensions. But as is mostly the case with government intervention in economic affairs, it actually brought about the opposite of what it set out to achieve. It caused the termination of nearly 30 percent of all private pension plans,[9] and imposed conditions that, in the end, may destroy the rest.

Before ERISA, the federal government had actively promoted private industrial pension plans. The 1942 Internal Revenue Act had made pension contributions by employers tax-deductible, made employee contributions tax-exempt, and offered deferred taxation of pension fund income until it was paid out as retirement benefits. With steeply progressive income taxation these deductions, exemptions, and deferrals provided powerful incentives for employer pension plans.

Private pension systems also multiplied as a result of radical government intervention in economic production. During periods of price and wage controls, as in World War II, the Korean War, and the Nixon era, many employers sought to circumvent the government controls by giving hidden wage increases in the

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form of pension benefits. Eager to remain competitive in the labor market, but prevented from raising wages, they introduced generous pension plans. Some funds actually meant to provide benefits for retirement, others were to be liquidated through distribution of assets after the controls were lifted.

After the passage of the Labor Management Relations Act of 1947, which made pension benefits a legitimate issue for collective bargaining, labor unions joined government in actively promoting pension systems. Facing frequent layoffs and chronic unemployment of their members, they directed their great strength toward gaining pension concessions for older workers in order to make room for younger unemployed members.

ERISA radically altered the basic nature of the pension system by placing government and its apparatus of coercion in the center of pension relations that heretofore had been completely contractual and noncoercive. Pension arrangements between a firm and its employees had been fringe benefits that reflected the choices and preferences of the contract parties. ERISA substituted mandates for contracts, and assigned additional benefits to employees at the expense of the firm's owners.

Through a comprehensive set of rules governing certain features of private pension plans, ERISA made it easier for workers to acquire legal rights to pension benefits. It prescribed certain rules of eligibility and "vesting" of nonforfeitable pension rights. It made the employer, instead of the pension fund, solely liable for pension obligations and imposed minimum funding standards. To satisfy pension claims, the pension fund may claim up to 30 percent of the firm's net worth. The claim has the same status as a tax lien, that is, it is senior to all other private corporate debt. Pension funds must be insured either with private insurance companies or the Pension Benefit Guaranty Corporation, an ERISA quasi-governmental agency. In case of pension default PBGC may force the firm into bankruptcy.[10]

Private Pension Systems Jeopardized by ERISA

The general attitude of businessmen toward the private pension system is one of deep concern and uneasiness. ERISA has severely curtailed their freedom to contract and administer pension plans and substantially raised their costs. What used to be a widely used tool in personnel management has become a serious liability that may threaten the future of private enterprises. But looking beyond the burdens and dangers of the present, employers and employees alike may derive comfort from the certain fact that

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politicians, in Congress assembled, may command, but individuals may evade, go around, outwit, and thwart the command.

Many pension plans have been terminated, many more will never be launched. The funds allocated to pension plans may be given directly to employees who may invest them in individual retirement accounts or just spend them. Where the ERISA mandates do raise labor costs, contractual fringe benefits and take-home pay will, in time, be reduced by the amount of ERISA cost so that, once again, the workers themselves will bear the total costs of their employment. Where such price and cost adjustments are impractical for any reason, they must expect lengthy periods of disemployment. For many elderly, who were supposed to be the main beneficiaries, ERISA may have erected the final barrier to employment and shattered the last hope for a pension.

Antidiscrimination Measures

The Equal Employment Opportunity Commission (EEOC) of the U.S. Treasury Department contributes its share of difficulties not only for the elderly, but also all other minorities. The Civil Rights Act of 1964 granted protected status according to race and sex; the Age Discrimination in Employment Act of 1967 extended the protection to the elderly. Later amendments to the acts further broadened government authority in all matters of discrimination.[11]

EEOC guidelines aim to ensure that employee selection does not discriminate against any group on the basis of race, color, religion, sex or national origin.[12] To that effect every employer is expected to engage the percentages of minority people that comprise the labor force in his locality. In a community where the population is preponderantly black, a plant must employ a corresponding percentage of blacks; in a Spanish-speaking community it must engage the proper percentage of Hispanic workers.

As any student of human action could anticipate, the EEOC strategy backfired immediately. It forced many employers to hire unqualified applicants just because they are members of a minority group and live in the community. Qualification, productivity and cost were relegated to secondary consideration, though these are the very factors that create jobs and assure economic survival in a competitive world.

To force companies to hire unqualified workers for any reason is to force them out of business. It cannot be surprising that EEOC contributed significantly to the exodus of business from the inner cities where millions of uneducated and untrained minority workers subsist on public assistance. To avoid the

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entire problem many companies have located new plants in largely white communities where minority workers face yet greater difficulty obtaining jobs.

Large corporations usually fear adverse publicity and, therefore, readily accede to the Commission's demands. They may commit themselves to an affirmative action program with specific hiring quotas, but are quick to close the plant as soon as it begins to suffer losses. While their spokesmen may lay the blame on antiquated equipment or foreign competition, every observer knows full well that the plant was destined to close by orders of the EEOC.

False labor doctrines, held by a great number of people and enacted by the U.S. Congress, have wrought much evil. Many millions of workers whom the laws were supposed to benefit now are walking the streets in idleness and despair. Their suffering manifests anew that political power is no substitute for equity and justice, and no surrogate for the inexorable laws of the market.

—FOOTNOTES—

[1]*Handbook of Labor Statistics,* U.S. Department of Labor, Bureau of Labor Statistics, 1980, p. 62; also *Budget of the United States Government,* Fiscal Year 1983, pp. 4–18. Also H.F. Sennholz, *Social Security—Is Reform Possible?* (Grove City, Pa.: Public Policy Education Fund).

[2]*Budget of the United States Government,* Fiscal Year 1983, pp. 5–149.

[3]*Budget of the United States Government,* 1984, pp. 5–120.

[4]*Unemployment Compensation: Final Report* (Washington, D.C.: National Commission on Unemployment Compensation, July, 1980), p. 78.

[5]Joseph M. Becker, *Unemployment Insurance Financing, An Evaluation,* American Enterprise Institute, Washington, 1981; G.L. Reid and D.J. Robertson, editors, *Fringe Benefits, Labour Costs, and Social Security* (London: George Allen & Unwin, 1965).

[6]*The Report of the National Commission on State Workman's Compensation Laws,* Washington, D.C., 1972.

[7]The determination of risk and safety does not basically differ from the determination of the length of work day. Contrary to prevailing opinion, which credits courageous union leaders and wise politicians with the gradual shortening of the work day during the 19th century, it was the workers themselves who determined the number of hours during which industry could operate most profitably. When wage rates rose due to capital formation and rising labor productivity, more workers chose more leisure over labor. They signalled their preferences to employers through cost differentials to which employers had to adjust. Labor union agitation for legislation aimed at restricting those workers in low-productivity occupations who still chose to work longer hours. Legislative restriction was designed to benefit union members at the expense of non-union workers.

[8]"What It's Costing Industry to Comply with OSHA," *Occupational Hazards,* Fall 1974, pp. 8–9.

[9]*The New York Times,* Sept. 8, 1977, section 4, p. 2.

[10]Dennis E. Logue, *Legislative Influence on Corporate Pension Plans,* AEI, 1979, p. 62 *et seq.*

[11]Robert M. Macdonald, *Mandatory Retirement and the Law,* AEI, 1978; Murray L. Weidenbaum, *Government-Mandated Price Increase,* AEI, 1975.

[12]EEOC, *Uniform Guidelines on Employee Selection Procedures,* June 24, 1974, p. 1.

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Ernest G. Ross

THE SIREN OF PARTNERSHIP

AN ANCIENT SOUND echoes across the troubled waters of American politics—a haunting, alluring chant. Free economy advocates must recognize that this is not a call which would lead America forward to a safe harbor of economic rejuvenation, but one which beckons ominously back onto the reefs of economic stagnation and decay.

This deceptive sound is none other than the plea for formation of a partnership between government and business. Several outspoken politicians have been pounding podiums about business and government "pulling together" to spark the economy. The essentials always come out the same: We must have a conscious, national decision to unify the major purposes of government and business.

The idea can be superficially attractive. After all, if both partners decided to move in the same direction, wouldn't much otherwise wasted energy be saved? In business, cooperative partners tend to do better than feuding ones. So why not seek the same kind of cooperation between government and business?

There is a fundamental reason why not. In a government partnership with business, it is always the government which becomes the more powerful, or "senior" partner. It is ultimately government which ends up setting the direction. And when that happens, the efficiency and morality of the free market are sacrificed.

The entire idea of free markets is that they be able to function without government intervention. Bringing government into the markets "merely" as a partner guarantees intervention. To see why this is so, let us review some of the major ways in which government might act as a

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partner with business: (1) by setting economic development goals, (2) by protecting preferred industries, (3) by subsidizing research and development, (4) by establishing favorable tax policies.

Setting Economic Development Goals

The argument for having the government set priorities in development is usually a variant of arguing for economic stability. If we had a national policy for development, goes the rhetoric, everyone would be able to plan better, to make business decisions without having to worry about conflicting viewpoints and antagonism between government and business. We'd all be setting our sails in a way that would best catch the wind and speed our jointly-run vessel ahead.

It sounds so easy—yet it is an impossible idea, one that has never worked. It is merely the old controlled-economy tenet put into slightly new language. And the central refutation of this tenet is still that no government, no national consensus, is capable of predetermining the market. The market is too vast, too complex, outside the scope of even the greatest minds to direct. Setting aside the fact that our economic planning bureaus are not suffused with the greatest of minds to begin with (as fifty years of government-managed economic boondoggles demonstrate), it is patently absurd to believe that deciding on economic development goals will make economic rejuvenation possible.

Will is not enough; that which is willed must also be consonant with reality; reality in this case is that the market cannot be accurately predetermined—only a god could do that, and men are not gods, nor can they become so by passing laws which assign themselves godlike duties. And since it is the senior partner of the government-business partnership which retains the power to make and enforce laws through coercion, it is to the senior partner, proven the less efficient of the two, that these godlike duties would accrue. Not only would we assign our partnership an impossible task; we would choose the less competent partner to make and enforce our economic decisions!

Even if economic development goals of this type could work, there still would be a serious moral barrier in the way: mandating certain goals automatically requires government to thwart other goals, the goals of individual producers (and consumers) who may not agree with the government. Their individual rights would be violated, they would be left with the dregs, with whatever tidbits of freedom of enterprise the government allowed them after its own major priorities and customers were served.

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This situation cannot be avoided under a government-business partnership. For when government swings its massive legislative and taxing powers behind certain favorite areas of economic development, other areas must suffer. This should become clear as we consider our next three major ways in which government might act as a partner with business.

Protecting Preferred Industries

The main form of industrial protection in our modern age is not the tariff, the tax break, or the subsidy. It is favoritism through government contracts. Establishing national development goals presumes that specific types of industries are necessary for the goals' achievement. A national goal of putting a base on the moon is unlikely to require much help from the lumber industry; a national goal of increasing employment by building thousands of new timber mills is unlikely to require the skills of those capable of building a moon base.

We've had a real example very similar to this. When Congress agreed with President Kennedy in the early 1960s that America should land a man on the moon, the redistributed tax dollars went to favored electronics, aerospace, chemical, and other related high-tech firms—economically, at the expense of other industries. And while the actual achievement of the moon landing was wonderful, a tribute to man's ingenuity, very few people thought to ask: What other companies might have grown up, what other firms might have survived—but did not—had all that tax money spent on the moon project been left to circulate freely in the economy? Would the same industries have thrived? Possibly—but good arguments can be made otherwise. The same questions can be asked about hundreds of government projects ranging from freeway construction, to public housing, to dam building, to economic consulting, to banking, to defense programs.

Further, because political pull is always a powerful factor in determining which firms receive bids for government contracts (despite assurances by the government of its own objectivity!), the case can be made that favored companies are not necessarily the best, not necessarily the ones most "deserving" to survive—not if we measure survival by the standards of the free market. Broadly applied, government protection of preferred industries tends to populate the market with the less able, the less efficient, the weaker. This in turn encourages malinvestment, lowers productivity, and depletes the overall health of the economy which the partnership was originally intended to strengthen!

As has been well documented

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elsewhere, other forms of protectionism have similar effects. But considering the enormous amount of government spending today, protectionism through government contract favoritism is by far and away the biggest form of it, if not the worst form.

Subsidizing Research and Development

We are often told that one of the ways the United States can regain its technological lead is by accelerating government subsidies of research and development. This is a central premise of the new "Atari" liberals, that group which wants a new government-business partnership to favor the high-tech industries.

But again, it is the main partner, government, which would be dealing the cards, deciding which areas of research and development are "most" worthy. We've all heard of the Golden Fleece Award type R&D projects receiving often quite substantial government funding—projects which, if R&D funding were left to the free market, would very likely stand a much tougher time getting the needed dollars. Perhaps to most of us, such projects seem the epitome of waste. Yet, they are precisely the result of our existing, implicit partnership between government and the scientific community. Worse than the questionable nature of such obscure projects is the economics involved: When government redistributes wealth to fund these pursuits, there is that much less money available in the market for perhaps much more productive endeavors.

What would those endeavors be? Neither you nor I can say, and that is precisely the point. It is the free market in scientific research which is distorted when the government is a priority-setting partner. How many new consumer products would we have seen, how many as yet unmade scientific discoveries might have occurred, how many new technologies would have been born had the market determined where R&D should go?

All we can say is that undoubtedly free markets make many different decisions about what is important to human beings—different from the decisions of governments. While we cannot predict the differences, we can confidently assert that the decisions would have more closely matched the preferences of the American public because that is what free markets are most adept at doing.

(As a counter to the contention that government R&D funding necessarily spawns government interference in research and development, it is often argued that much of the money goes to universities or other institutions which are free to determine for themselves how to spend the money. However, this misses the central

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point that a free market may not have given *any* funding to those universities and institutions—or, perhaps, many times *more!* Governments are no more proficient at determining "worthy" institutions or schools than they are at determining "worthy" individual scientific projects.)

Establishing Tax Policies

Setting the tax structure has always been a major function—and weapon—of government. Tax breaks or deductions would be a key tool of any new government-business partnership.

The power to selectively lower taxes is an effective way for the state to encourage the growth and development of industries which its goals require. When one industry is allowed to keep more of its wealth than another, it will stand a much better chance of survival. In a sense, it is a bizarre sort of favoritism.

One cannot morally begrudge a policy which allows an industry to keep more of what it has rightfully earned. But one can begrudge the fact that other industries are allowed to keep less. This is the way the situation should be viewed. Both morally and economically, the emphasis should not be on the "unfair" tax breaks some companies get; it should be on the higher tax rates which remain imposed on other industries. The tax money is not the government's first; it is the producers'. The chief inequity is not in the selectively lowered taxes, but in the majority of selectively higher ones.

Higher taxation discrimination against some industries is a method for keeping those industries from becoming dominant in a way the government might consider inappropriate (or less appropriate) to national goals. This is the other side of the goal-setting coin: The "senior partner" must not only actively aid the industries it favors; it must keep penalties on those it disfavors. If it did not, the latter would rise in the marketplace, impudently reflecting the priorities of those whose choices the government has ultimately usurped: the buying public.

It should be clear that the call for a "new" partnership between government and business is not only a bad idea, but an old one. It is merely another cry from the haggard Siren of central planning.

In order to attain economic rejuvenation of the American economy, it is not a partnership we need. Rather, it is a dissolution of a *de facto* partnership. Government has already muscled in too heavily as a participant in business planning. The more we can push government back out of the market place, the faster we'll free Adam Smith's invisible hand to help bring a lasting recovery to America.

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HERBERT HOOVER: *The Engineer*

GEORGE NASH, the author of *The Conservative Intellectual Movement in America Since 1945,* was an inspired choice to write a definitive biography of Herbert Hoover, who had the bad luck to be President at the onset of a depression that turned many an intellectual to an ill-considered radicalism that still dogs our political life. As the historian of the contemporary conservative revival, Nash is just the man to touch hands with an earlier America, when an orphaned Bertie Hoover, the son of an Iowa blacksmith, could scratch his way through geology courses at Stanford University to make his fortune in mining ventures all over the world and "retire," at age 40, to start a second career in public service that led to the White House at a most inopportune time.

Mr. Nash has been at work on his Hoover biography since 1975, when the Herbert Hoover Presidential Library Association of West Branch, Iowa, picked him to carry through with a job of research that is still several years from completion. The first installment of Nash's undertaking, *The Life of Herbert Hoover: The Engineer, 1874-1914* (New York: W. W. Norton and Co., 768 pp., $25.00), is at hand, a work of tremendous detail that recreates a vanished world in a way that stresses many an irony.

The world that Herbert Hoover was so busy building as a young engineer and financier was brutally murdered, when, in 1914, the "guns of August" signalled the end of a hundred years of peace. World War I gave Herbert Hoover the opportunity to make a reputation as a public servant, but it utterly cancelled the meaning of many of the projects that had engaged his attention in the years when he was building his fortune by wresting mineral wealth from gold and zinc mines in Australia, coal mines in northeastern China, copper mines in Russia, and lead and silver slag piles in Burma.

Hoover's first mining labors, as a young American engineer sent to the "outback" of West Australia by the English firm of Bewick, Moreing, were to bring some order and continuity to gold mining in places where the yield demanded the most careful kind of cost-cutting. The trick, even

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along the so-called Golden Mile at Kalgoorlie in the "Westralian" bush, was to make low grade ore deposits pay a margin of profit over a long enough period to justify the expense of good stamping equipment.

The irony of Hoover's career in gold mining is that it presupposed a world in which gold would continue to be the "unit of account" in currency systems. But the pre-1914 world of the gold standard barely outlasted Hoover's mining engineer career. And it was England's attempt to revive the standard at an unrealistic level after the war that helped bring on the depression that ruined the Hoover presidency.

Hoover's cost-cutting success in the Australian "outback" was repeated in China, where he took on the job of getting rid of "squeeze" in the operation of the rich Kaiping coal mine. But political troubles doomed the efforts of Hoover's boss, C. Algernon Moreing, to make a good thing out of any Chinese concession. It was the time of the Boxer uprising. Hoover and his young wife, Lou Henry, survived the Boxer troubles, but his company couldn't solve the problem of dealing with Chinese officials who had to reckon with laws that gave to the Imperial Court the ownership of all minerals in the ground. Hoover had a low opinion of the Chinese as workers—they "lacked mechanical instincts." He argued that China would never manage to accumulate a "social surplus" for modernizing its economy until it had found a way to control its population growth.

The Life of Herbert Hoover: The Engineer may be received postpaid, by sending a check or money order in amount of $25.00 to Herbert Hoover Presidential Library Association, Inc., P.O. Box 696, West Branch, Iowa 52358.

If the "squalor of Asia" depressed Hoover, he had greater hopes for Russia. In his last days in London as an engineer-financier, he played a big part, mostly behind the scenes, in putting the Kyshtim copper mines in the southern Urals on a paying basis. He helped run pools in Kyshtim stock, he raised debenture money for the enterprise, and he profited by taking stock options. He made two trips to Russia, where he approved the "humane and progressive" attitude of the Baron Vladimir Meller-Zakomelsky in trying to improve the conditions of the peasants and workers at the bottom of the Kyshtim "pyramid." But at a rail station in Russia Hoover caught sight of a chain gang of prisoners headed for Siberia. The horror of the scene gave him nightmares. He felt that "some day the country would blow up." This was in 1912.

Despite the chain gangs, Hoover believed that western money and engineering expertise could do much

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for Russia. In 1913 and 1914 he backed his friend, the ebullient and optimistic Leslie Urquhart, in Russian ventures. Urquhart launched the Russo-Asiatic Corporation, with Hoover on his board. The corporation acquired three extraordinary mining concessions in Siberia, including 3,000 square miles in the southern Altai mountains not far from the Mongolian border. By the summer of 1914 Hoover's Russian mining enterprises were in sight of spectacular success. Hoover also had oil interests in the foothills of the Caucasus Mountains in southern Russia.

Nash quotes Hoover as saying he stood to obtain "more than is good for anybody" out of his Russian enterprises. But "it was not to be." The enterprises that Hoover and his associates helped to guide in the Urals and Siberia all evolved toward eventual prosperity. But the Bolsheviks got all the benefits.

Hoover's long absences from America only served to make him feel more and more American. He took special pains to take time off from money-making in London to become a big benefactor of Stanford University, which made him a trustee. It was Hoover who insisted on raising the salary levels of the Stanford faculty at a time when the university was having trouble luring good teachers to its Palo Alto campus. If World War I had not intervened Hoover would have returned to California, where he hoped to settle himself and his family on the Stanford campus.

Nash is remarkably even-handed when it comes to dealing with Hoover's quarrels with his London partner C. Algernon Moreing, who made Hoover promise to refrain from practicing his profession of mining engineer on British Empire soil as a condition of leaving Bewick, Moreing to become a financier. Hoover and Moreing had always kept their distances from each other. Their quarrels were not always seemly on either side. Nash remarks on Hoover's "marked sensitivity to criticism." Hoover, he says, would go to "extraordinary lengths . . . throughout his life to rebut alleged misrepresentation."

What Nash implies is that Hoover was too thin-skinned to be a politician. But that is something for another volume.

DEATH AND TAXES
by Hans F. Sennholz
(Center for Futures Education, P.O. Box 489, Cedar Falls, Iowa 50613), 1982
105 pages • $5.95 paperback

Reviewed by Brian Summers

HERBERT HOOVER put it right on the line: "The American people have from the earliest moments been alive

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to the evils of inherited economic power. Several million dollars is economic power and too often it falls into the hands of persons of little intention to use that power for public benefit either in expansion of enterprise and employment or for public services. It is the breeding ground of playboys and playgirls of morally obnoxious and degenerating character."

For once, President Hoover was in touch with the majority of the American people. Most Americans dislike playboys and snobs, and estate taxes are a good way to give them their comeuppance. Estate taxes make good political sense.

But estate taxes make no economic sense. As Hans Sennholz clearly shows, estate taxes produce very little revenue (less than 1 per cent of projected 1983 federal receipts), consume scarce capital, distort the structure of production, lead to costly avoidance schemes, and promote more conspicuous consumption than perhaps any other tax.

Of course, estate taxes do not level factories like a B-29. But when the tax comes due, stocks, bonds, farms, and family businesses must be sold to pay the bill. This consumes productive capital which is needed in other sectors of the economy. The old factory remains standing; the new factory is never built.

Confiscatory taxation leads to avoidance and evasion. The simplest way to avoid estate taxes is to avoid leaving an estate. Sell the business, retire early, and spend it all while you can. Thus, even in the grips of recession, luxury items sell at a brisk pace, while essential industries languish for lack of investment capital.

Jewelry, furs, precious metals, gems, works of art, and bearer bonds are easily transferred, difficult to trace, and thus particularly amenable to tax evasion. When all else fails, there is always the Swiss bank account or Liechtenstein family foundation.

Having taken such a dim view of estate taxation, it is not surprising that Professor Sennholz offers a few avoidance techniques of his own. An expert on inflation, he shows how the inflation that can destroy a family fortune can be used to facilitate the tax-free transfer of wealth between generations. These sections on family annuities, limited partnerships, revocable living trusts, family mortgages, corporations, holding companies and other techniques are required reading for those who want to protect family wealth in an age of inflation and estate taxation.

Death and Taxes also is available and may be ordered at $5.95 from The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533.

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